FDI in Colombia: Overview, opportunities, risks, and strategies

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Introduction
In this global world, the business transactions face fewer boundaries every time, since the nations are moving forward to become more integrated, not just with their neighbors but also with far away countries. The business world appears like divided in two parts: the United States of America and the European Union, and the developing countries. On one side, United States of America and The European Union, the most historic predominant economic motors, fight to recover their vigorous economic performance; while on the other hand, developing countries are taking the initiative. The developing nations are making the internal changes, mainly in their legal system, to attract more Foreign Direct Investment (FDI) in order to satisfy their own necessities: a strong economy, a competitive infrastructure, and acceptable levels of living standards (Nunnenkamp, 2001; «The Global Competitiveness Report 2013-2014», 2013).

Nowadays, FDI is an annual billionaire operation (Görgen et al., 2009), involving the whole globe. Gradually, the barriers are falling down to welcome the foreign financial resources, appearing a symbiosis between investors and hosts. The first group is expecting to place its capital surplus to extend the market, increase their own efficiency or find natural resources (Demirhan & Masca, 2008); the second one is needing the financial resources to move forward on the development level (Adewumi, 2006; Ronderos-Torres, 2010; Žilinské, 2010).

Developing countries’ rulers have found on FDI a vital source of progress and development since they face a strong pressure with regards to living standards and macroeconomic performance. Consequently, most of these nations have made internal adjustments in which the foreign investment rights, domestic production protection, and taxation system are conceived in a way in which the nation appears attractive enough. These adjustments are normally made according to the country's circumstances, political tendencies, and internal strengths and weaknesses (Rehman, Ilyas, Alam, & Akram, 2011).

An Overview of Colombian FDI
Colombia started its integration with the global economy in 1992 through different legal reforms compiled on a state policy called Economic Openness. With this course, the country moved from a strong protectionism system, in which the economy was dominated by a weak purchasing power, high inflation, poor-goods quality, among other facts; into a progressive market opening that brought a desired business competition in the domestic market. This competition changed dramatically the national industry; multiple national companies could not support the new scenario and gradually lost the participation in the market until disappearing (Martínez, 2012). After one decade, the largest surviving industries appeared more competitive even as transnational corporations or large exporters, and, also, new companies in several sectors opened up operations. Currently, the country exhibits powerful enterprises especially in banking, food, energy, mining, and insurance sectors (PROEXPORT COLOMBIA & Ministerio de Comercio, Industria y Turismo, 2013).

In the last 10 years, the FDI in Colombia has shown a solid raising tendency, due to internal progresses such as the national security improvement (resulting in a safer access to the large natural resources in the countryside), and the market transformation (which created great likelihood of developing non-traditional business) (BANCO DE LA REPÚBLICA, 2013). During the same period, the country has
experienced an economic mineral boom that has irrigated the whole economy and has had a positive social impact within the country (Martínez, 2012). Therefore, the nation became an economic miracle being part of the CIVETS (six emerging market countries which include Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa) (¿Qué son los civets?, 2010).

Regarding Colombian FDI, the inflows come mainly from the United States of America (20%), Panama (13%), Chile (10%), Spain (9%), Anguilla (10%), and England (10%), which account for 72% of the total inflows, showing a poor level of diversification. The total amount, for the period between 1994 and 2013/1T (excluding petroleum and revenues reinvestment), reaches US 81,983 MM according to the Central Bank (BANCO DE LA REPÚBLICA, 2013). In 2013, Switzerland and England showed an important increase on Colombian inflows; on the contrary, Spain has been disinvesting during the last 3 years (BANCO DE LA REPÚBLICA, 2013). Moreover, it is notable the Asian absence in spite of its economic expansion, investors from the region do not have a relevant investment in Colombia. It is also notable the modest presence in Colombia of other large economies that do not appear in the top 10 FDI ranking for 2013 (e.g. China 6 $mm, Japan 65$mm, Germany 50$mm). Finally, regional countries investing in Colombia are: Chile 436 $mm, Brazil 244 $mm, Venezuela 71 $mm, Peru 49 $mm (BANCO DE LA REPÚBLICA, 2013).

The most invested sector inside the country is related to natural resources (including petroleum and minerals) (BANCO DE LA REPÚBLICA, 2013). This investment concentration is evaluated as a risky position due to: i) a sector with poor value added, ii) an economic activity that demands low manpower, iii) a not renewable sector, and iv) an activity that involves the risk of environmental destruction. Conversely, other analysts argue a more optimistic point of view in this regard; they assess that FDI in this sector may have a positive impact on the whole economy by irrigating different industries, pushing them to grow, and becoming, later in the future, economic strengths (Hyman, 2011).

Furthermore, Colombia was considered as a risky place to invest in the recent past; as a result, those foreign investors that finally invested demanded multiple extra conditions like higher return rates, a direct government protection, etc. (BANCO DE LA REPÚBLICA, 2012; Segura, 2010). However, during the recent years, the country has lived an upsurge of new foreign investors looking for a place to develop businesses with a moderate level of risk. Nonetheless, it is true that these actors are mostly coming from EU, US, and Canada; but there is a notable emerging phenomenon of increasing number of investors coming from developing countries, which take a position and compete one to one for the domestic market, natural resources, and efficiency. This singularity is not just happening in primary sectors, it is a certainty also in secondary and tertiary ones (BANCO DE LA REPÚBLICA, 2013).

Since FDI becomes more relevant, the Colombian government has started to regulate the activity. Lambaerde and Garay (2009) highlighted the principles for FDI in Colombia, which were included in the National Constitution: “i) Equality rights (13th Article, ii) Private property rights (58th article), iii) Equality civil rights for foreigners (100th article), iv) Economic freedom until the common welfare limit (333th article), and the state role regard as the general direction for the economy (334th article)” (De Lombaerde & Garay, 2009). Also Proexport explains about the foreign investors rights: “the Colombian political constitution establishes that foreigners and nationals have the same rights (in investment terms), consequently the foreign direct investment is allowed almost in all the economical sectors, with few exceptions. Therefore, the principles for FDI are: impartial of treatment, universality, automaticity, stability” (Proexport, 2013).

**Analysis of opportunities and risks for FDI in Colombia**

The openness might be considered as the most relevant factor to run a business in Colombia. During the last two decades, the country has been moving forward to emerge as a competitive country in the global economy; and as a consequence, the country has signed significant Free Trade Agreements (FTA) with representative economies in the World, such as the United States, the European Union, and
In addition, there are other FTAs in force, with almost every single nation in the Americas, while other significant FTAs are under negotiation with powerful nations like South Korea and Turkey. Also, the nation has currently a global integration, which includes not just exporting, but also re-exporting, offshoring, assembling, conducting FDI, etc. Hence, the market size is also a notable factor to set up businesses in Colombia. During the last 10 years the country has experienced a positive trend on the GDP; even moving positively in 2008, during the worst recent financial recession. The GDP in 2013 was close to USD 466 billion, 4.4% higher compared to 2012 according to the Central Bank (COLEMAN, 2012; Jiménez Giraldo & Rendón Obando, 2012; Mogrovejo, 2005; PROEXPORT COLOMBIA & Ministerio de Comercio, Industria y Turismo, 2013; Ronderos, 2010; «The Global Competitiveness Report 2013-2014», 2013).

Additionally to the determinant factors, the Colombian population represents a vigorous size, reaching 47 million inhabitants, which places it as the 3rd most populous country in the Americas, after United States, Brazil and Mexico. The domestic market has become attractive enough to be considered viable for numerous multinationals coming from diverse regions. The phenomenon provokes a desired effect on the middle class, which is moving into a growing path due to public investment, better education access, more effective methods for subsidies distribution, and lower regression on the taxation system (COLEMAN, 2012; Mogrovejo, 2005, 2005).

In the same way, the balance of trade shows how the exports have increased approximately 250% since 2004, upgrading to USD 60 billion while producing a trade sustainable surplus. The macroeconomic benefits are affecting in a positive way the exchange rate and the national welfare, giving a powerful public position to invest on the sensible factors, such as: infrastructure, education, health, and social system (BANCO DE LA REPÚBLICA, 2013).

Moreover, the employment rate in Colombia has evolved in a positive tendency, especially during the last three years, with the exceptional amount of jobs that come from innovative activities. Nothing comparable with the behavior experienced 10 years ago, when the unemployment rate was, in average, above 10%, even reaching alarming levels, e.g. in January 2004 the rate jumped to 17%, producing a devastating social effect, predominantly in the middle and poor social stratum (Mogrovejo, 2005).

Moreover, Colombia presents a stable and progressive competitive position in the last decade according to the Global Economic Forum. The evolution is explained by the equilibrium in the public finance, the control of the inflation rate, and the reduction of the public debt. The same report also remarks the strong and modern financial national industry and the domestic market size. It also classifies the country as an economy in “efficiency drove level”; showing a transitive path that progressively abandons primary economic activities («The Global Competitiveness Report 2012-2103», 2012).

In the same way, the double taxation agreements have given large benefits to investors avoiding a double payment for the same business revenue. These treaties facilitate the consolidation of business relationships since the tax regulation framework is one of the most unlikely obstacles for foreign investment in Colombia. The agreements represent a relevant leverage for investors due to the tax exemption if the investment comes from countries under those agreements; especially, regarding capital repatriation (PROEXPORT COLOMBIA & Ministerio de Comercio, Industria y Turismo, 2013).

Even though the Global Competitiveness Report (2013), when referring to the education system quality, lists Colombia in the 86th position, among Argentina 104th, Bolivia 89th, Mexico 119th («The Global Competitiveness Report 2012-2103», 2012); the competitive labor force of the country has been recognized as one the most competitive in the region in relation to professionals and technicians. Additionally, a business report of KPMG (2012) defines the Colombian labor force in a competitive level due to strong commitment to quality, objectives, and loyalty. Besides, the labor cost in Colombia,
compared with other developing countries such as Mexico, Chile, and Brazil, reveals an average rate («Infrastructure Opportunities in Colombia | KPMG | CO», 2013).

Notwithstanding the Colombian improvement, the country still remains laggard on multiple factors. The World Economic Forum in its Global Competitiveness Report («The Global Competitiveness Report 2012-2103», 2012) highlights the institutional weakness and the public corruption as the most negative factors, together with the poor national infrastructure and the quality of the education, which are notably damaging features that affect FDI inflows. The country presents a critical delay on its national infrastructure: there are lacks in bridges, tunnels, routes, and railways affecting the competitiveness when facing other products from the world. For example, Colombia is the 97th out of 120 countries in Km/inhabitants; while the density of pavement roads is lower than 0.015 km/km². Consequently, the transportation affects the production that has exporting purpose. The country is rich in biodiversity, minerals, petroleum, gas, but in cases, due to the poor developed infrastructure, the final price exceed the possibilities to compete. (Gonzalez, Guasch, & Serebrisky, 2007).

In addition, the low productive government bureaucracy has a negative effect on business transaction. In this regard, the National Constitution of 1991 pursues the government decentralization looking for a more effective function, empowering departments and cities to plan and to execute the programs according to the main necessities, working in a common union with the central government mainly on finance transactions, social programs, and engineering for large projects. Despite the constitutional amendment, the infrastructure remains poor in comparison with other nations in the region. In this way, the organization Transparency International published, last year, the corruption perception index, ranking countries according to the perception of corruption in the public sector. Colombia was placed 94/177, showing a humble level and still a long way to grow in this matter. In general, the corruption persists principally in the public sector where licenses, permissions, diligence, and other tasks are taken according to the benefits agreed between the two parts: the public agent and a private executive. Besides, when government acts directly, e.g. building a route, railway, dyke, at the end scandals regard to over costs are the common news. On the private sector, the corruption is perceived in a lower level, but still happens, especially true when there is interaction with the government via biddings.

Finally, Colombian financial system is one of the most developed in the region, and it is also known by its stability. In spite of that, the banking system exhibits an extravagant capital cost, not only in the public sector but also in the private side. Furthermore, the covering and the competitive cost are still precarious; small companies do not have an easy access to the vital financial resources or they do have access but with excessive interest rates (COLEMAN, 2012; Jiménez Giraldó & Rendón Obando, 2012; MOGROVEJO, 2005).

Analysis of FDI strategies in Colombia
When observing diverse sectors in Colombia is evident the presence of several foreign firms, also true when following the growing amount of external financial resources that entry every year to the country. However, while examining closely, many firms from outside are not moving in the traditional way that they did in the past, the current level of globalization is forcing many companies in the country to go further in order to keep the competitiveness. Hence, it was not weird that 20 years ago, firms ought to develop their own operation starting from zero, bearing the responsibility in every single part of the value channel and also controlling all the variables. The conception for running businesses changed dramatically even in a developing country like Colombia. Foreign firms are setting up their local operation based on the national business framework, founding support in local (public and private) institutions to do crucial activities like market research, legal tasks, analytical activities, and also recruiting and empowering national people as directors and workers. Likewise, many firms that have underestimated local factors have seen themselves involved in extra barriers and mistakes, especially when considering human labor and institutions that are needed to provide support. For that reason, while planning the operation, foreign companies should look for support on domestic entities...
and people, and take it as a competitive factor to act quicker and more precisely. Then, international players intending to access the market may find an advantage engaging domestic human resources.

In general, M&A and Joint Venture are common strategies for different businesses in Colombia. One reason to explain the issue may be the preference that foreign firms exhibit to start operations by taking position on existing firms, avoiding the cultural learning curve and also accessing the market with a relevant operation to keep a progressive expansion.

Also, there is evidence about the comparative advantage cost between setting up the own operation against acquiring an existing framework. A reasonable explanation about the phenomenon may lie on the plus value that foreign firms assigned when making a business financial valuation for the expansion potentiality («The Global Competitiveness Report 2012-2103», 2012). It must be said that in Colombia is common to use financial tools to make an economic assessment, being the present net value of cash flow the most popular one. The Joint Venture is also common among the strategies, due to the national complexities and peculiarities, several foreign firms find more accurate to meet their interest with local experienced public and private institutions to develop business, taking advantage on the experience, cultural knowledge, national legislation understanding, own operation, best willing to perform on the local alliance, etc.

There are sectors in the country in which foreign firms might use their international strategy without major inconveniences, this is especially accurate for ripe and massive industries and brands. Colombian consumers even having their own peculiarities does not differ from other customers dramatically (i.e. expressly talking about west regions, not necessarily valid for other regions).

Mine and Energy, Transportation, Banking, Agribusiness, among other industries, need extra efforts in order to design single strategies. The motivation for the design might be supported on the sectorial stage, cultural conditions, and current legislation. Specifically, the internal affecting factors match with the corresponding risks from the previously mentioned sectors, leading managers to face the circumstances using different market tactics; conversely, it is not precise to deal with different market challenges with the same strategy; mainly, when the critical variables differ deeply.

**Suggested FDI Strategy in Colombia**

Among multiple strategies, such as: M&A, franchises, representation, licenses; to find a local agency as partner is one of the most advisable strategies to start operations. This type of operation includes the participation of two or more firms, each one with part of the knowledge in the corresponding field; the alliance shares, both, risks and revenues:

What type of local partner? A local agency working in the same field (not necessary doing the same activity), with an understanding of the investors’ activity. For instance, a firm working in infrastructure (that plans to bring FDI into Colombia) may have on local engineering or architecture company a strategic partner to conduct the due diligence. For example, Hewlett Packard Company (2012) found in EAFIT University the perfect partner to set up operations in Medellin - Colombia, mainly commissioning EAFIT University to research on sales, BPO, and post-sale service (Universidad EAFIT, 2012).

Which tasks may the local partner conduct? This strategic partner may conduct the internal due diligence in the industry, working with the investor’s plans in order to identify crucial factors, like: Does the market offer the expected conditions? For instance: market-looking firms need to determine if the market size, apart from the population, has the potential market niche to introduce products or services. Then, the strategic partner must: i) assess current similar products or services already under production or commercialization in the marketplace, distinguishing the strategy that other firms use, examining potential strategic differentiation, determining the sale channels, understanding the whole business condition, identifying the price and final cost to lay out the financial viability, etc.; ii)
research and advise on the legislation that applies in the investor’s industry, such as licenses, permissions and restrictions. Every single country’s legislation has their own particularities; consequently, a generalization in this matter may lead to costly and unnecessary mistakes; and iii) assess human factors.

How to define the responsibility? This is a key issue to avoid future conflicts. The contract should express clearly and unequivocally the obligation, detailing objectives, tasks, and duties. In addition, it will be very necessary to define the applicable time, range, investment profiles, and responsibilities, besides the restrictions during and after the contract, in terms of acquired knowledge, plans, forms and other matters that each part had to access. It is also important to define how the parts are going to communicate, the language and the forms to use, the periodicity to make reports. Even simple tasks are recommended to put on writing, keeping in mind that business procedure and conducted forms vary deeply according to the education system, cultural affairs, and region. These types of considerations are expressly true for firms far away of the region, such as Asia, Africa, and Middle East.

How to define the remuneration? If possible, the best way to determine the remuneration will be by commissions according to the performance because when the payment is attached to achievements, it involves efficiency in Colombia; for this reason, the previous aspect should conceive measurable objectives. The national Colombian culture is quite aware about this type of remuneration; therefore, it is not difficult to negotiate an agreement with commissions. Although the commission system is accepted, firms may receive a rejection regarding payment based on a commission system; in this case, other forms could be considered such as: fixed or mixed methods.

Conclusions
Despite the fact that the real impact of FDI is still under discussion, several authors defend the evidence regarding its role in improving the development in host countries, due to the contribution made through capital resources, knowledge, and dynamism. Moreover, the existent literature studies the determinants that investors observe while addressing FDI in developing countries. Some authors say that market size, openness, population, infrastructure, and GDP per capita are the most relevant factors to make FDI decisions.

The FDI in Colombia, during the last decade, has shown a positive evolution based on improvement of the national security, the legislation system, the taxation system, and the large stock of natural resources. For Colombia, the positive affecting FDI factors are the market size and the GDP per capita. The negative affecting factors are poor infrastructure, bureaucracy, and corruption. On the other hand, the risks for FDI that are taken into account when thinking in developing countries are: internal conflict, bureaucracy, and corruption.

Furthermore, foreign companies in Colombia have used different strategies to address FDI. However, globalization is forcing firms to act more precisely; hence, finding a strategic partner to conduct FDI is currently the most recommendable strategy to enter the domestic market. This strategy is based on 3 principles: cost reduction, risk control, and time saving.

References


