



PERSPECTIVE

Colombia's Tourism Turnaround

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In the past, Colombia had a somewhat dubious reputation among travelers that, unfortunately, kept many from experiencing its numerous charms. Colombia's government and its people have risen to meet many challenges over the past decade, working to improve the country's attractiveness to international tourists as well as investors. After a recent visit to Colombia, I found the country to be an appealing travel destination with an incredible variety of attractions, festivals and natural beauty including snow-white beaches, mountains, tropical jungles, waterfalls and even volcanoes. My colleagues and I also recently explored the many potential investment opportunities in the country and were generally encouraged by what we saw and heard during our visit.



In Cartagena, Colombia

Our first stop in Colombia was Cartagena, which has an interesting historical background. The city is an important center for oil refining and a major port; as our plane was landing, we could see large shipyards with modern cranes unloading a German container ship. We felt, however, there was probably better investment potential for Cartagena tied to tourism, and wanted to find out more about that aspect.

Tourism on the Rise

In 2015, some 2.5 million foreign tourists visited Colombia, up about 12% from 2014 and nearly triple that of 2005.¹ Weakness in Colombia's currency (the peso) has encouraged foreign travelers, particularly those from the United States as the US dollar has doubled in value against the peso over the past year and a half. Cartagena gets its share of tourists but I think there's no reason why it couldn't match the numbers of visitors to Bogotá, the country's capital and leading tourist destination.

In the recent past, tourism in Colombia has suffered because of drug-related violence in the country. However, the Democratic Security and Defense Policy of Álvaro Uribe Vélez (Colombia's president from 2002-2010) designed to regain government control and fight illegal drugs and organized crime, and the "tourist caravans" (caravanas turísticas) proved largely successful. The tourist caravans involved military forces that provided reinforced protection on specific days on roads to major holiday attractions.



Cartagena, Colombia

The full name of Cartagena in Colombia is actually Cartagena de Indias (Cartagena of the Indies) to differentiate it from the city in Spain from where it got its name. Tourists in Cartagena, Colombia, not only enjoy the tropical climate, the beaches and sea, but also the incredible colonial-era buildings in the old fortress city. The city was a key port for the Spanish empire from the 1500s to 1700s and became a center for wealthy traders, soldiers and royalty. The walled city and fortress is designated as a UNESCO World Heritage Site.

Gold and other treasures from all of Latin America were the impetus for the city's early growth since the port was an ideal jumping-off point for the Spanish galleons to ship treasures to Spain via Havana. Cartagena's walled city and fortress are among the best-preserved of any in the Americas, probably because having such wealth made it the target of Spain's enemies in Europe as well as pirates.



Cartagena, Colombia

Walking around the old city was a joy for me since it took me back to colonial times when the city was the jewel in Spain's Latin America crown. Within the fortress walls are streets and alleys lined with old colonial buildings which have been beautifully restored into all kinds of shops from cheap tourist trinkets to high-end fashion stores, restaurants and hotels. As we were walking, we came to a square near a cathedral where singers and dancers were holding an impromptu concert. Further on, we had to avoid horse-drawn carriages taking tourists through the narrow cobblestone streets. We passed an elegant hotel originally built in 1621 that formerly served as a Catholic convent, charity hospital, a prison and a school of medicine throughout its history. In 1991, a group of Colombian investors restored the building and many artifacts were found hidden under the ruins, water wells and other parts of the foundation. The nuns' former dining room was transformed into one of the city's most-famous gourmet restaurants.

Cartagena's walled city today is just a small part of what has become a major metropolis. The Boca Grande (Big Mouth) area between Cartagena Bay and the Caribbean Sea includes most of the tourist attractions, including hotels, shops, restaurants, nightclubs and art galleries, as well as beaches with volcanic gray sand and comfortably warm water to match the warm weather.

We also visited a new, modern mall in the city, along with high-rise developments and the port and industrial area. Cartagena's port services cities all over the country with truck drivers converging there. The drivers we encountered using a popular, on-demand car service were polite and helpful, and I peppered them with various questions to get a local perspective as we toured the city. When my colleagues and I saw a police barrier with cars being stopped, I asked our youthful driver whether the police were honest. His answer, "no," was equally honest and quick. Unfortunately, we have found corruption is fairly widespread around the world (even in developed countries) and is often considered a cost of doing business. The good news is that with smartphones and the Internet and the like, it is becoming more transparent and there have been strides in eradicating it in many areas.

We scanned the Spanish-language newspapers for other topics of concern to the city and nation, with one interesting headline translated as: "The Economic Environment Is Difficult but Not Dire." The paper featured an interview with President Juan Manuel Santos and quoted him as saying that if peace with the FARC rebels is accomplished it will be the most spectacular year in the country's history. FARC, a Marxist-Leninist guerrilla movement fighting the government since 1964, is short for "Fuerzas Armadas Revolucionarias de Colombia," translated into English as, the "Revolutionary Armed Forces of Colombia." The United States and Europe consider FARC a terrorist organization responsible for a number of crimes. Colombia's government and FARC have come together over the past month to negotiate a possible bilateral cease-fire agreement, although a full peace deal remains elusive for now.

Summing up our trip to Cartagena during the weekend, it was clear to us that the city was a great tourist destination that is certain to attract more visitors in the coming years as Colombia's reputation as a safe and peaceful country begins to gain wider acceptance.

Medellín

Our next stop was the city of Medellín, which features a mountainous landscape dotted with skyscrapers that seem to be climbing them. When I first visited Medellín in the 1990s, I felt a lot of trepidation upon landing at the airport because Medellín and Cali were known as "drug capitals" with drug cartels ruling those cities. I could understand why Medellín could be a perfect hiding place for criminals because of its many hills and mountains covered with thick forests. However, once I checked into my hotel and started visiting companies and talking with people, I felt more at ease, and my colleagues and I realized that despite its reputation, legitimate business was being carried out and perhaps some of our fears were overblown.



In Medellín, Colombia

Founded during the Spanish colonial period in the early 1600s, Medellín has a long history and was named after a village in Spain. Medellín is Colombia's second-largest city (after Bogotá) and has a population of about four million. Given the difficult terrain where Medellín is located, one would not expect a city of this size to have sprung up, but the production and export of gold mined in the surrounding mountains explains the attraction. During colonial times, the city was a prime target for Spanish explorers who were sucking up all the gold and silver they could get their hands on in Latin America to ship back to Spain. Later, the environment was found to be ideal for coffee production, which became a key export and encouraged the development of a class of ambitious traders and entrepreneurs whose descendants have now made the city a powerhouse of innovation and growth. Today, there are a number of world-class companies based in Medellín which have extended their businesses all over Latin America and elsewhere. Access to the city continues to improve amid a number of infrastructure projects including airports, better roads and railroads. To overcome the incredibly mountainous terrain even in the heart of the city, there is a 1,260-foot-long outdoor escalator that brings passengers to villages on the mountains. There are also plans for tunnels to connect the airport to the city so travelers can avoid the arduous, albeit spectacularly scenic route.

Home to the Medellín Cartel headed by the infamous Pablo Escobar, the city was the site of various drug wars in the 1980s. Since the death of Escobar in 1993, violence declined and in 2002, former President Álvaro Uribe ordered the military to disband urban militias such as the FARC as part of a key effort to reduce overall violence in the country. There were a number of other efforts to improve Medellín, with hotels, museums, parks and other facilities developed along with infrastructure improvements. Most of Medellín's major newer buildings include public art, and today the city is a vibrant, welcoming place for tourists.

On the business side, one of Colombia's largest conglomerates is located in Medellín, so we took the opportunity to meet with one of the group's directors, who remembered meeting me a number of years ago when he was a securities analyst. He told us about a recent reorganization and expansion, and conveyed that he is seeing more potential opportunities for growth tied to the region's growing middle class. We talked about the intricacies of doing business in the region—including Brazil—which offers the added challenge of a different language (Portuguese) than the majority of Latin America (Spanish).

Looking at Latin America overall, officials at the company confirmed to us that the region had suffered from currency devaluations and higher interest rates. However, the real economies in the region have been doing fairly well and corporate profit-and-loss statements of many companies appeared healthy. We talked about the lifestyles of Latin America's 22 million middle-class people, and the proliferation of financial products targeting them as they save and invest for their futures. The company took the innovative step of hiring anthropologists and sociologists to actually live in communities throughout Latin America to observe how money was used and spent as well as studying the daily life of the people.

Barriers to Businesses—and Risks

Similar to our experiences visiting Brazil and other countries in Latin America, we learned that misguided government regulation was considered one of the biggest risks or concerns expressed by businesses in Colombia, but we also learned how companies were overcoming challenges and finding new areas of growth.

On my recent trip, I returned to a cement producer that I had visited back in 1998. I recalled how the managing director had assured us the company would be able to survive during what was then a very challenging time. Fortunately, it did! We laughed about how I expressed a lot of fear about the health of the company and how he said: “Don’t worry, Mobius!” This time we discussed the Colombian government’s “4G program,” the fourth generation of infrastructure plans to build roads connecting all the major cities in the country. Of course, this effort would require a large amount of cement; in Colombia, cement consumption is still dominated by small users who buy the cement in bags and not in bulk. Housing represents an area of additional potential growth, not only for cement but other industries and companies in the country, as the median age of Colombia’s population is under 30,² and as these young people get married and have families they will need improved housing and will likely purchase other consumer goods.



Medellín, Colombia

With global operations, the cement company offers an example of how companies in Medellín have expanded into other countries to tap new markets. We discussed how freight was a very important part of the cost of cement and therefore cement is very much a local industry serving a market of within about a 100-kilometer radius around a plant.

While oil represents less than 10% of Colombia’s gross domestic product (GDP),³ oil exports remain an important part of government revenue. Energy prices affect transport costs, but also ripple through other areas of the economy. When visiting a bank, the first question we asked was about the impact of low oil prices on the bank and the country generally. A good coffee harvest in 2014 helped offset some of Colombia’s oil-related earnings, but the threat of drought in some of the coffee-growing areas in 2015 and early 2016 is having an adverse impact on government budgets. Therefore, the bank executives speculated that another round of tax reform to fix a fiscal deficit could be coming in the form of a value-added (VAT) tax or perhaps even a dividend tax.

The bank executives were also concerned about an uptick in inflation. In February, consumer price inflation rose 7.5%—quite a bit above the government’s target of 2% to 4%—leading the nation’s central bank to raise interest rates in March for the seventh month in a row.⁴ The recent increase in inflation was mainly due to a rise in food prices and was expected to come back down a bit going forward, but bears watching. Nevertheless, the bankers felt that the potential for financial services was strong, as it is estimated that about a third of adults in Colombia have no financial accounts.

I also returned to visit a food company that had specialized in chocolate production (Colombians generally drink hot chocolate for breakfast instead of coffee or tea) but has been branching out since then into other areas, including the restaurant business, and expanding globally through acquisitions. I recall one of the executives telling me about two decades ago (amid my early trepidation) that Medellín was a great city with lots of potential and an important industrial center. His assessment proved right! The plant we visited was very impressive and clean, and all the workers we saw were wearing white uniforms.

The executives we spoke with said the government's tax reform efforts were generally bad for business, and we talked about how the "wealth tax" discouraged investment. Therefore, they said that they were not opening more plants in Colombia but expanding manufacturing in other countries where the tax and investment incentives were better. The weaker exchange rate for the Colombian peso has been good for many export-oriented businesses in Colombia though, since it made their products more competitive and discouraged foreign competition from coming into the market.

Labor strikes are another problem facing businesses in Colombia. In early 2016, the Central Union of Workers (Central Unitaria de Trabajadores de Colombia, CUT), the largest trade union federation with 500,000 members and over 500 unions in the public and private sectors, threatened work stoppages and strikes in protest of a government decree granting a 7% rise in the monthly minimum wage to about US\$212 per month. The CUT said it would challenge the decree at the Council of State (Consejo de Estado), Colombia's highest administrative court. You would think the increase would be celebrated, but the CUT claimed the increase violated the constitution because it was below what it deemed as the inflation rate.

The first focus of Colombia's new government is law and order, which includes neutralizing or disbanding the various revolutionary movements in the country. Besides FARC, another group the government has had to deal with is the National Liberation Army (Ejército de Liberación Nacional, ELN), which came under pressure to work with the government in light of FARC's willingness to negotiate. The Úsuga clan is another criminal group which has committed a number of crimes including tapping oil from oil pipelines, some of which was apparently used for producing cocaine. The Colombian Petroleum Association estimates that as much as 300,000 barrels of oil were stolen in 2015.

Although the challenges are great, Colombia's government has by and large risen to meet them. In its annual evaluation, the local chapter of Transparency International, the group that monitors corruption in governments around the world, reported significant improvements in transparency among public service companies in Colombia on variables such as openness, dialogue, rules and control. Unfortunately, those improvements were not reflected in perceptions; Transparency International's public perception index indicated that the perception of corruption in Colombia has actually risen since 2012 despite the fact that corruption itself declined.⁵ This may be because of the increasing use of smartphones, which has accelerated communications between members of the public and simply made them more aware of these matters.

Over the many years that we have been investing in Colombia, we have seen great improvements. The government's reform path is clear, and if it is able to resolve issues regarding FARC and other groups, we believe conditions for investors will likely further improve. More importantly, if Colombia's government is able to resolve its budget issues without resorting to burdensome taxation, while moving privatization forward to fund infrastructure developments, we think the future could be very bright for this beautiful nation.

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1. Source: Colombia Ministry of Tourism.
2. Source: CIA The World Factbook, as of 2015.
3. Source: The World Bank, as of 2014.
4. Source: Bloomberg LP.
5. Source: Transparency International Corruption Perception Index, 2012-2015 data.