

Business Environment of Latin America

# E-Commerce in Latin America: The Success of MercadoLibre

Executive Summary: This paper will provide a case study of the firm MercadoLibre, as well as a future assessment of e-commerce in Latin America. Operational and strategic initiatives for both foreign and Latin firms will be evaluated based on data. The business model of MercadoLibre will be examined as it relates to the current e-commerce environment of Latin America. Consumer behavior, government regulations and future technology trends as it relates to MercadoLibre's business will be discussed. How MercadoLibre has succeeded, and what the firm can do in the future to maintain its market share will be examined, along with a number of strategic recommendations.

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## Introduction

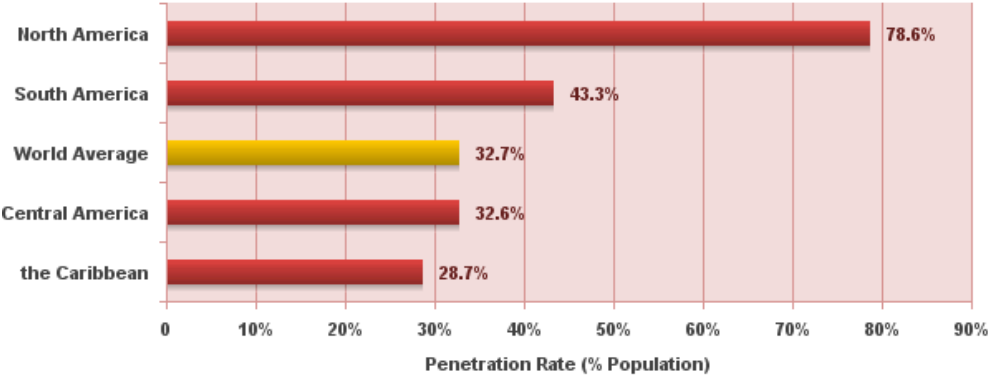
In this paper, we will attempt to examine how online commerce (e-commerce) has, is and will develop in the future in Latin America. We will use the company MercadoLibre as the main case study example for several reasons, but mostly because it is the dominant player when it comes to e-commerce in Latin America. This paper will examine the reasons that MercadoLibre has succeeded in becoming Latin America's largest e-commerce firm, as well as the challenges that it and other firms are likely to face in the future. We will also be able to examine the state of e-commerce in Latin America taking into consideration social, political and macroeconomic factors. We will examine what is influencing the use of e-commerce platforms, and also how the wider adoption of e-commerce technologies could affect the strategies of major firms in the industry. E-commerce is currently causing a large shift in the way both consumers and businesses engage in Latin America, and the way firms like MercadoLibre align themselves with this shift will be very important to their future success or failure.

## Background of E-Commerce in Latin America

This first section will document a brief history of e-commerce in Latin America, and examine the factors and forces currently influencing the industry in the region. Among these factors include access to technology, IT infrastructure, economics and socio-political norms and issues. Compared to the United States, Europe and other more mature economies, internet adoption and usage is fairly low and underdeveloped. This is due to several factors, including lack of telecom and IT infrastructure and high cost to consumers to purchase the necessary technology. The cost of purchasing data plans for consumers through their local telecom carrier (such as Claro) can also be prohibitive and is currently a barrier to higher internet penetration

rates in the region. This being said, internet penetration rates in Latin America have been growing substantially over the past decade, as many countries in the region have recovered from financial crisis, been able to contain inflation more than in the past and are experiencing growth in GDP per capita. A growing middle class particularly in countries like Brazil and Colombia are main drivers of these increasing internet penetration rates. However, the percentage of the Latin American population that has regular and convenient access to the internet remains low as compared to the United States and Europe, which makes it an attractive growth market in the near future for many tech-related companies should this trend continue. Telecom industry has been in consolidation recently, with firms like Mexican company America Movil acquiring local carriers and consolidating them under its Claro subsidiary. The following graph illustrates the overall internet penetration rates of Latin America as compared to the rest of the American region and the rest of the world:

### Internet Penetration Rate in the Americas December 31, 2011



Source: Internet World Stats - [www.internetworldstats.com/stats2.htm](http://www.internetworldstats.com/stats2.htm)  
Approximately 508,887,286 Internet users in the Americas on December 31, 2011.  
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From an IT infrastructure standpoint, Latin America lags behind most other developed nations. According to the World Economic Forum's latest report, Chile ranks the highest of all Latin American nations in terms of IT Network Readiness at number thirty-nine in the world. Next is Uruguay at forty-five, followed by Brazil at fifty-six, Peru at ninety and Argentina at ninety-six (Global IT Report, 2011, pg. 13). Venezuela, Bolivia and Ecuador lag significantly behind their Latin American peers in terms of IT infrastructure and network readiness. However, e-commerce does exist in those regions, with MercadoLibre currently gaining 11.6% of its net revenues from Venezuela, for example (MercadoLibre 10K, pg. 25).

In addition to the physical IT infrastructure, another factor that will likely impact the future of e-commerce in Latin America is the mobile financial infrastructure. The United States is a leader in mobile technology and applications that enable e-commerce to take place from a mobile phone, utilizing wireless infrastructure, affordable phones and applications developed by firms such as EBay to facilitate easier and higher volume transactions. The mobile sector of e-commerce is growing quickly, particularly in emerging markets such as Indonesia where families and individuals are more likely to own mobile technology rather than a personal computer with an internet connection. In 2011, the World Economic Forum published a report on specific regions and countries with regards to their current development with regards to utilization of mobile financial services. We can use some of this data to infer the readiness of Latin America as compared to other regions with regards to the current and potential state of mobile e-commerce. The graph below compares major emerging market nations with regards to both their market readiness and adoption/availability of mobile financial services in. Highlighted are the two most advanced Latin American countries as it relates to mobile financial services. The relatively low adoption rates shown in this graph is more evidence that Latin America has a high growth

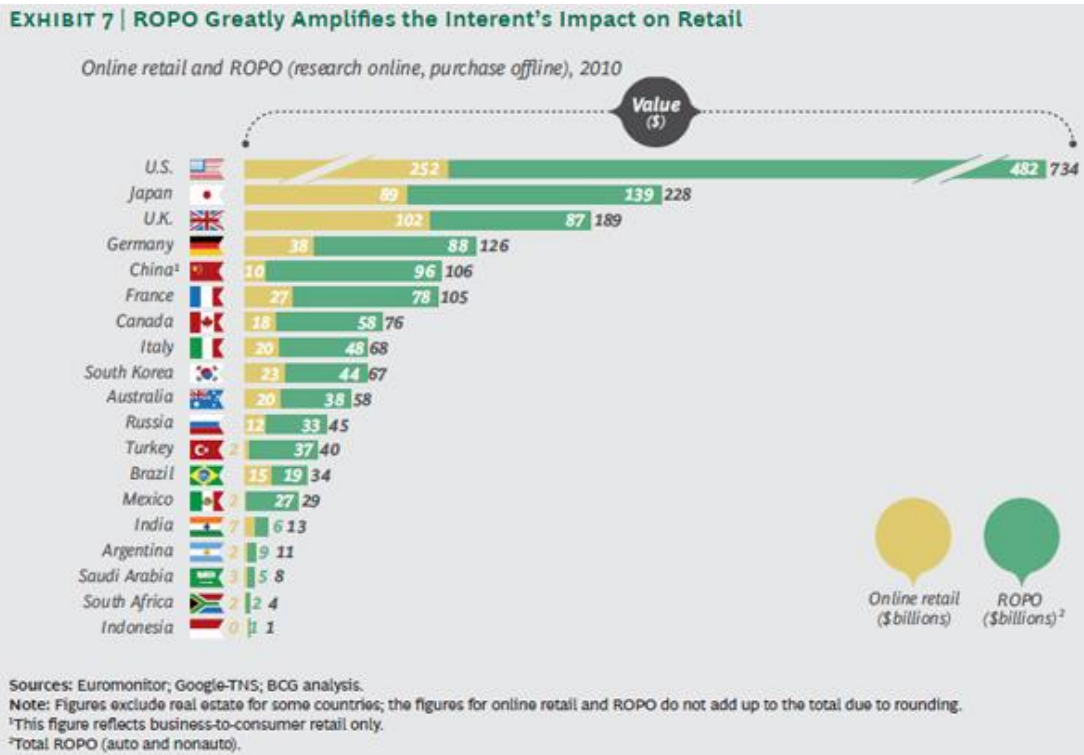
potential in e-commerce, should the adoption rates rise to become more comparable to other emerging markets:

Figure 3: Adoption and availability versus market environment



Source: Adoption of Mobile Financial Services based on stock-taking amongst mobile network operators by The World Economic Forum.

Research Online, Purchase Offline (ROPO) is also another measure of internet access and e-commerce adoption. Although these are not direct e-commerce transactions, they closely reflect the rates at which consumers use their mobile phones to compare price while they shop in order to find the best bargain. Researching price online would indicate that those consumers would be more likely to make future e-commerce purchases. The Boston Consulting Group (BCG), expects both developed and developing members of the G20 to see the internet playing a bigger role in their economies, with Mexico advancing the most of the developing nations at 1.7 percentage points (Minto, pg 1). With this in mind, BCG conducted a study of ROPO rates in nations across the world, as illustrated by the chart below:



Although Mexico has the highest amount of ROPO purchases, almost triple that of the next highest Latin country (Argentina), the aggregate dollar amount lags significantly behind many other countries. One challenge that MercadoLibre faces is to raise this number, and make e-commerce a part of the normal shopping experience in Latin America.

However, not only market environment factors will determine future adoption rates of both mobile and traditional IT e-commerce platforms, but also the government regulatory environment in various nations. Unlike the United States and Europe, e-payments and internet security are new, and solutions to potential fraud and identity theft are still being debated. Policy solutions and laws can vary between countries, making it difficult for e-commerce firm to ensure that they are in compliance with all laws and not liable for any frauds or consumer complaints. Recently, the regulatory trend in the region is strengthening of legal, technological and control measures to ensure that personal data is handled more securely between countries in the Latin

American region (Cyber Regulation, pg 3). The Ibero-American Data Protection Network, currently comprised of most Latin and Central American nations, is currently working to harmonize data protection across borders and help standardize legislation as it relates to data security (Cyber Regulation, pg. 3). These security measures are crucial the expansion and future success of e-commerce in the Latin American region. If MercadoLibre can implement reliable security measures as it relates to their payment processing business, MercadoPago, it will place itself ahead of other competitors in the region as the most integrated e-commerce company. Presently, MercadoLibre is not able to process payments and transactions across borders due to both cyber-security and currency exchange issues. However, a uniform regulatory framework throughout Latin and Central America as it relates to cyber-security would aid MercadoLibre in potentially expanding its MercadoPago business.

In addition to this, Argentina, Paraguay, Uruguay and the European Union are currently participating in the MERCOSUR Common Market Group, an international initiative to promote e-commerce in Latin America and Europe. Gerson Rolim, a regional MERCOSUR coordinator for Brazil, states that “The main area to harmonize is e-commerce and cross border internet transactions, that is, anything related to customs, logistics, customs and taxes (import and export duties), generating confidence in the internet and protection of personal data...At the same time, it is important that governments not over-regulate the digital economy” (Cyber Security, pg 10). This kind of international cooperation is also important for Latin e-commerce firms such as MercadoLibre. It appears that the regulatory trend in the region is positive, and that government regulations appear to be most aimed at preventing cyber-crime, rather than over-regulating.

### The Story of MercadoLibre

MercadoLibre currently is the most dominant e-commerce firm in Latin America. It is three times bigger than the second e-commerce site in Latin America, the 8<sup>th</sup> most popular overall website in the region and the 11<sup>th</sup> largest e-commerce site in the world (Galparin, 2011). MercadoLibre is a publicly held company traded in the NYSE under the symbol “MELI” with headquarters in Buenos Aires and offices across Latin America. The goal of MercadoLibre is provide services that are designed to provide users with mechanisms for buying, selling, paying, collecting, generating leads and comparing listings via e-commerce in an effective and efficient manner. MercadoLibre offers users an ecosystem of four related e-commerce services: the MercadoLibre marketplace, the MercadoPago payments solution, the MercadoClics advertising program and the MercadoShops on-line store solution (MercadoLibre 10K, pg 4). The company was started in 1999 by Marcos Galperin, a Stanford MBA student from Buenos Aires, Argentina. After an initial round of venture capital investment from the Hicks-Muse firm (among others) in Texas, MercadoLibre opened its website in August in 1999 only for Argentina, and later that year opened to Brazil, Mexico and Uruguay. After two more rounds of financing from Goldman-Sachs, by 2006 MercadoLibre had begun operations (chronologically) in: Colombia, Venezuela, Chile, Ecuador, Peru, Costa Rica, Republica Dominica, and Panama. However, not all of these regions have been made available to services other than the basic MercadoLibre Marketplace. For example, MercadoPago has only been launched in Argentina, Brazil, Chile, Colombia, Mexico and Venezuela.

MercadoLibre made several strategic partnerships, acquisitions and changes in business models in order to facilitate its growth. First, in 2001 MELI sold 20% of the company to American e-commerce firm EBay. In addition to giving MELI access to the e-commerce expertise and experience of EBay’s management, EBay also signed a five-year “no-compet-



agreement” in which EBay agreed not to open any e-commerce website in Latin America through 2006. Additionally MELI was also given EBay’s Brazilian e-commerce website iBazar, a main competitor in the region. The next year in 2002, MELI acquired its next major competitor in Brazil, DeRemate (which was founded by a group of Harvard MBA graduates). This acquisition not only gave MELI a huge market share of Brazil, but also gained 1.3 million users of DeRemate from Colombia, Venezuela, Peru, Uruguay and Mexico. Since then, MELI has pursued a strategy of acquiring smaller competitors in various areas of e-commerce such as payments, classified listings, business-to-consumer (B2C), consumer-to-consumer (C2) and online advertising. Through the process, MELI has adjusted its business model in several ways in order to be successful in the Latin American region, which due to the factors stated in the previous section, is much more challenging due to IT infrastructure and access to the latest technologies and the internet. A major change that they made was moving away from being primarily an auction website to a fixed price exchange marketplace between the buyer and seller. This was likely successful in generating more transactions because buyers did not need to be online for a greater amount of time to monitor their auction bids. MELI also began offering free listings for sellers, which was somewhat risky. However, it was a wise choice, since e-commerce is relatively new to the Latin region, and sellers did not want to pay to list their products or services if they were unsure if they would sell or payments would be secure. MELI generated a huge number of users and transactions from this strategy, as many of the sellers were happy with the platform and willing to pay for more high visibility listings. In addition, integration of the MercadoPago solution created an e-commerce infrastructure and advantage that very few other firms, even EBay, do not have. This reduces a “friction point” between buyers and sellers online, because instead of buying through one firm and then paying through

another, both are conducted under the same umbrella. Currently about 20% of all transactions are made through MercadoPago. Finally, MELI has also been able to offer products similar to Amazon.com through its MercadoShops storefronts. Many small, medium and a few large retailers sell their products and services through a “virtual storefront” on the MercadoLibre website at a fixed price, allowing consumers to have some access to brands and companies that they are familiar with. MercadoClics allows some of the largest firms to advertise deals on the MELI website for a fee, but transactions are made when the consumer clicks the link that leads them away from MercadoLibre and to the website of the larger firm’s website where the transaction is made. In these ways, MercadoLibre has managed to combine various aspects of successful U.S. e-commerce firms such as Amazon, eBay and Craigslist in order to become the most dominant in the region, and potentially the first “E-Commerce MultiLatina”,

#### Cultural and Contextual Changes in Latin America and E-Commerce

As mentioned in the previous section, internet use and access in Latin America is growing at a rapid rate. Both physical infrastructure and IT infrastructure is improving in many regions. However, unlike the United States, buying habits tend to vary much more widely depending on the region. For example, in Brazil, the top categories for online purchase are Home Appliances and Books. However, in Argentina, the top categories are Personal Electronics (portable video games, cameras etc.) and cell phones (Almeida 2011). These personal tastes of consumers in different countries illustrate a larger contextual change happening in Latin America, which is rapidly increasing access to the internet, consumer electronics and technology in general. While MercadoLibre is currently the dominant player in e-commerce, how will they be able to cope with larger numbers of users each year? As users increase, so does the room for increased competition from other e-commerce firms and entrepreneurs. While MELI obviously

dominates the region, they do face competition in Argentina from auction website Mas Oportunidades and in Brazil from the Amazon-style company Submarino. While internet access is the larger contextual change, perhaps more important is the increasing access of people to mobile and smartphones. Large amounts of e-commerce is conducted via mobile phones in the United States, and although the barriers are steep for most Latin American consumers to acquire the same technology, mobile phone usage will inevitably increase over the next several years.

Government regulation is another aspect that is likely to change in the near future with regards to e-commerce in Latin America. While firms like EBay and Amazon have the benefit of operating generally within one uniform regulatory framework, MercadoLibre must abide by the laws of each separate nation that it operates in. This has the potential to radically alter MercadoLibre's ability to operate as it has in the past, as well as potentially have a significant impact on revenues. Nowhere is this truer than Venezuela, where the potential of nationalization of certain industries (like telecommunications) or government taking control of the internet could have a drastic effect on MELI. In general, most Latin American countries do not have fully developed laws and policies as it relates to e-commerce, cyber-fraud and secure payments online, therefore how MercadoLibre is able to position itself in the local economies and governments of each country with regards to public policy will have a big impact on future success.

### Strategic Options for MercadoLibre

Being low in debt and with substantial cash reserves, MercadoLibre has left itself in a good position to peruse a variety of strategic options in the future. The most obvious strategy that MELI can employ is to maintain its current growth strategy. That is several things, including acquire smaller competitors that fit into its business model. Expansion of the MercadoPago

business is also another main strategy, due to the fact that MercadoPago is limited to only a few countries. The same can be said for MercadoShops and MercadoClics.

If MercadoLibre wants to imitate the Amazon business model, it is possible that they could distribute products as a strategic option. Currently, MELI only connects buyers and sellers through their website. They could reduce another “friction point” by selling goods through a MercadoLibre storefront independent of the vendors that currently sell on the website. A downside of this strategic option would be driving away sellers to other competitors, as the sellers realize that MELI is able to sell the same goods at a lower cost due to its advantage in supply chain and volume discount. Opening a small number of distribution centers in strategic locations, such as Argentina, Brazil and Mexico could help the company improve efficiency and capitalize on the improving transportation and shipping infrastructure in Latin America.

The most powerful option that MercadoLibre has is to take advantage of the e-mobile commerce market. As CEO Galparin says, he hopes that in the future MercadoLibre consumers “Can buy things anywhere, from a mobile phone, from a tablet etc.” (Galparin 2011). If MELI is able to develop mobile applications in which consumers can make purchases securely and conveniently they will be able to increase the number of transactions and expand the MercadoPago business to increased profitability.

### Strategic Recommendations

From the standpoint of strategy, MercadoLibre can expand their business in several different ways to increase their market share. First, they should continue their strategy of acquisition of smaller competitors based on the number of users that can be gained. The past MELI acquisitions have gained many users, and they should continue to leverage their

partnership with Ebay to evaluate competitors that can be acquired in order to maintain their market dominance.

Second, MELI can expand the MercadoPago business as a major payment platform in Latin America. As mentioned before, only 20% of all transactions are conducted through this platform. By working with governments of each country to ensure secure transactions and compliance with local regulations, MELI could possibly become the major e-commerce payment platform in the region. It may even be possible that the MercadoPago platform could be viable for consumers to purchase goods across borders should Cyber Regulation become more uniform.

Finally, MELI should pursue aggressive development of mobile phone purchase platforms. Although access to technology like smartphones and tablets are currently more expensive to Latin American consumers, the numbers are steadily increasing. MercadoLibre should strive to create a simple, secure and easy way to make transactions through mobile phones to create more transactions in order to maintain their market dominance. Monitoring the regulatory environment in each country, especially Venezuela, is an important part to this component of expansion.

### Summary

MercadoLibre is a unique and innovative success story of e-commerce in Latin America. One of the key lessons that can be learned from this is the ability to adapt to the different consumer behaviors of Latin America. Simply adopting the EBay or Amazon business model would not have yielded as much success. The ability of MELI management to quickly react and change is very important to their market dominance, as e-commerce is relatively new to the region. If other firms expect to compete in the future, they need to do as MELI did, and ensure

secure payment as well as reduce friction points such as shipping. Being aware of the regulatory environment of each individual country is also important to all Latin e-commerce firms. By diversifying business in multiple countries, risk is reduced. If any certain countries become unfriendly to e-commerce business, it will be easier to adapt and expand business elsewhere. In the end, it can be said that MELI not only looked at what Latin consumers are currently doing, but what the e-commerce and technology adoption trends will be in the future in order to deliver services to the region that benefit both the company and consumers.

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