



Late Latin America's
Digital Ecosystem

Executive Summary

Accelerating Digital Trade in Latin America and the Caribbean

2017

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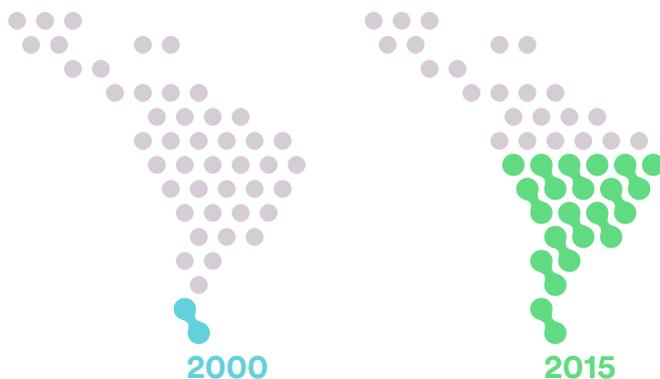


The Internet roared to the scene in Latin America and the Caribbean (LAC) and it is transforming the way Latin Americans interact, shop, bank, and spend their time. The Internet is changing regional consumption patterns, the landscape of regional companies, and the region's economic prospects.

Disruptive digital technologies riding on the web — cloud-based services, e-commerce, 3D printing, Internet of Things, and so on — are empowering LAC companies of all sizes to cut costs, improve customer service, and create brand new products and services. The region is also home to innovative digital companies run by intrepid entrepreneurs, some of whom have accessed significant investments from Silicon Valley and grown into some of the world's leading online businesses.

The Internet, in short, has opened tremendous new opportunities for LAC economies to become more productive, expand opportunities for entrepreneurship, and drive inclusive economic growth.

The digital revolution is also shaping LAC's trade patterns. It also creates new scale economies: entrepreneurs and businesses building new digital services and platforms in such areas as payments and shipping can regionalize their offerings at a far lower cost than brick-and-mortar peers, and service multiple markets with a lean staff.

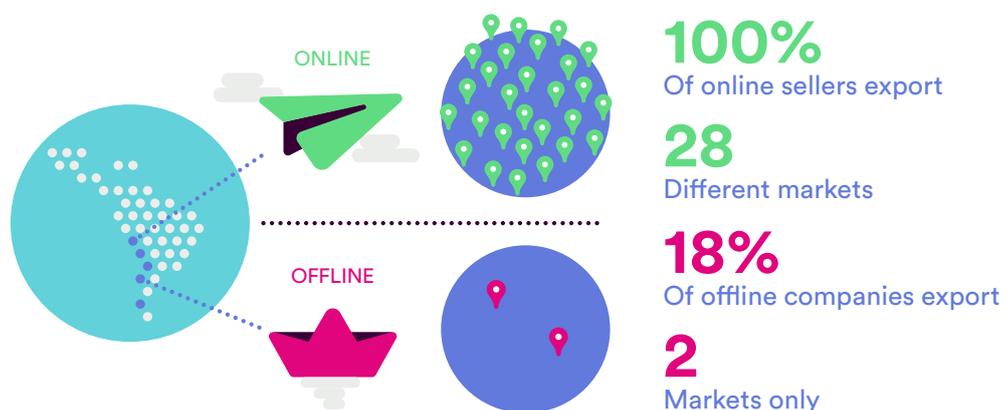


While in
2000 fewer than 5%
of Latin Americans
used the Internet,
by 2015, half of the
región was online

There are at least five ways in which the Internet can be hypothesized to shape LAC trade patterns:

1 Increased small business exports and export diversification

Enabling buyers to find and evaluate sellers anywhere in the world, the Internet reduces the geographic distance which for centuries has limited visibility and thus trust between small buyers and sellers located far apart. For example, eBay's data shows that in Chile, 100 percent of online sellers export, on average selling to 28 different markets – as opposed to the mere 18 percent of Chilean offline companies that export, and export typically only to 2-3 markets. These patterns are echoed in other LAC markets. As more LAC companies become able to set up online stores and start selling and buying on e-commerce platforms such as MercadoLibre and Alibaba, the region's prospects to expand small business trade multiply.



2 Expansion of trade in services

Traditionally known as an exporter of manufactured products and commodities, LAC nearly doubled trade in services in 2000-13. The Internet has played a role in this revolution, fueling online financial, logistics, and educational services, as well as apps, games, and other new digital services. By leveraging cloud-based tools, LAC entrepreneurs can offer anything from an ecommerce site to a bank to a genomics company to customers around the world, all the while handling millions of hits and requests without building their own IT infrastructures. And microwork platforms are expanding opportunities for LAC freelancers and small businesses to sell their services, or engage in “trade in tasks”, with businesses in other countries.

3 Streamlined trade operations

The Internet not only enables companies to do more trade, but to optimize their trade – streamline logistics, gain foreign market intelligence, pay and transact quickly and securely, access financing, comply with trade rules, and overall improve the various aspects that go into cross-border trade and transactions. Productivity and growth gains are particularly significant as traditionally analog companies turn to the Internet to manage their cross-border operations, regional and global supply chains, and global customer interactions.

4 Wider variety at lower cost

LAC companies often depend on imported inputs for their competitiveness, especially in small LAC markets with limited local supply. The Internet improves their sourcing: by using the web and various platforms, even the smallest companies can identify and vet suppliers and shop around for the best deal worldwide. Similarly, regional consumers are scoring welfare gains by accessing online a wide variety of goods and services from domestic and foreign sellers.

5 Genuinely regional small businesses and startups

The Internet creates new economies of scale by enabling “born-digital” companies to launch in several markets in a quick sequence. By leveraging cloud-based tools, entrepreneurs in LAC can build a regional footprint. For these companies, the capital expenditures and barriers to enter new markets are far lower than they have traditionally been for the brick-and-mortar companies in such sectors as manufacturing and agriculture – and even these industries are now digitizing.

Taken together, trade flows powered by the Internet can usefully be grouped under term “digital trade” – international trade in which the Internet and Internet-based technologies play a major role in building, finding, ordering, producing, marketing, or delivering products and services. Indeed, digitization and the Internet are redefining what is meant by goods and services and markets for them.

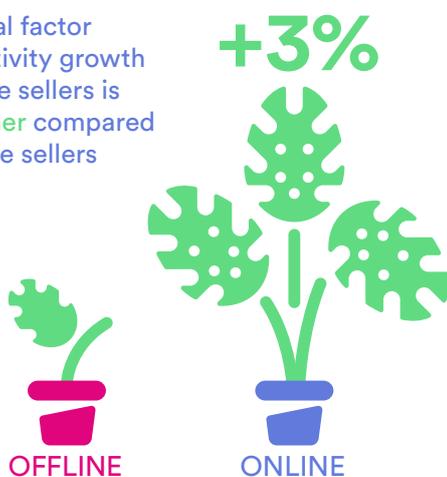
However, there is little data and mostly only anecdotal evidence on the power of the Internet on trade in the LAC region. Data on the barriers to digital trade in the region is still lacking, and so are fresh ideas on policies to unlock digital trade. This curtails regional policymakers’ ability to make informed policy choices. The purpose of this report is to start filling these knowledge gaps and drive digital trade in LAC.

Digital Trade Empowers LAC Companies

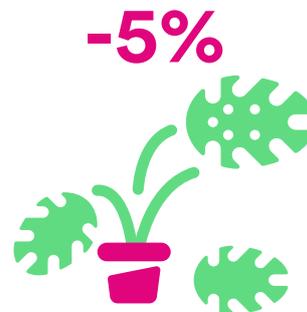
Some of the key findings of this data-driven report based on a survey of nearly 300 LAC companies are as follows:

- The Internet has become central to LAC companies' daily operations. The bulk of companies surveyed here use the Internet for internal communications, advertising, market research, and ordering products and services. Even companies in the traditionally analog sectors such as manufacturing and agriculture are heavily leveraging online sales and purchasing capabilities.
- The Internet is also a hugely important growth lever for LAC companies: it improves companies' interaction with customers, streamlines their operations, and helps them access new markets for their products and services, among other benefits. The Internet is also ingrained in LAC companies' daily business: the bulk of regional companies would incur a productivity loss of 15 percent or more if the Internet were taken away.

The total factor productivity growth of online sellers is 3% higher compared to offline sellers



89% reported productivity losses of 5% or more if there was no Internet



77% reported productivity losses of 15% or more if there was no Internet



- Traditionally only a fraction, some 13 percent, of LAC companies have exported, and often derived only a minor share of their revenues from exports. However, over 50 percent of the surveyed companies – ones with some online presence and typically some online sales – sell and buy online across borders, and often derive nearly 50 percent of their revenue from export sales. Online presence also has earned LAC companies new foreign customers they did not have before selling online.

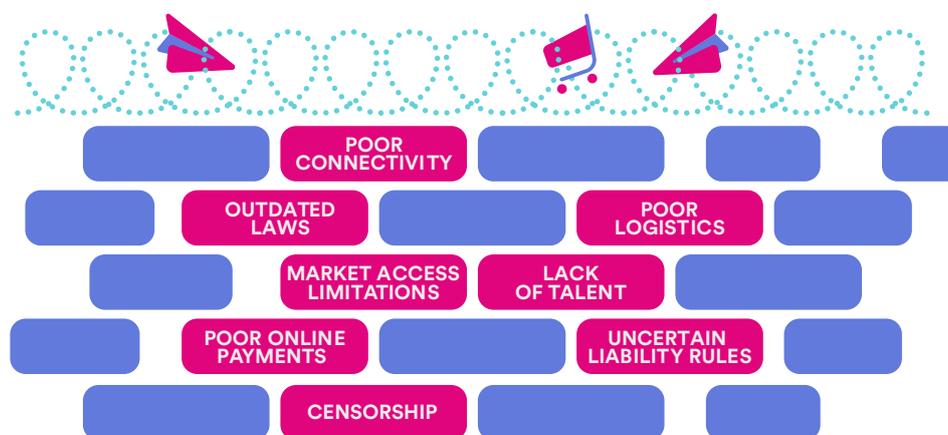
Over 50% of small companies are making cross-border sales and purchases



- For many South American online sellers, cross-border online sales are geared to the intra-regional market, whereas Mexican companies transact mostly with the United States. Europe is also a significant market for LAC companies, and China features prominently as a source of supply.
- LAC companies are upbeat about their future foreign sales. The average company surveyed here forecasts over 200 percent growth in revenue from foreign sales in 2016-18, while the median company forecasts growth rates of 40 percent during the period. Several companies engage in trade within the intra-regional market and consider LAC to be an important market in years ahead.

Challenges to Digital Trade in LAC

Online trade is only starting in LAC: there is much more growth to be had. To harness it, policymakers need to attend to some of the key constraints identified in this report:



- Most LAC economies trail countries at similar levels of development in the “enabling environment” for digital trade, such as in mobile subscription rates, firms’ technology absorption capacities, business-to-business and business-to-consumer Internet use, and in the political and regulatory environment for information and communications industries. The region still has significant “e-frictions” compared to advanced nations.
- Of those LAC companies that already sell and buy goods and services to and from foreign markets, 50 percent find market access barriers as a “very significant” obstacle to their digital trade, while over 40 percent find the same for poor logistics in other markets and 30 percent for online payments as well as customs procedures. A third see too many uncertainties stemming from Internet intermediary liability rules. Notably, these various barriers obstruct small companies much more than large ones.
- If these obstacles to selling online and cross-border were removed, LAC companies report they would score an average of 65 percent revenue growth from international sales and 50 percent from domestic sales. Companies that are intensive digital traders – that derive over 50 percent of their online sales revenue from foreign markets – expect 90 percent revenue growth from foreign markets and 51 percent in the home market if these obstacles were removed.



- While some of the challenges to digital trade are external to companies, many are internal. LAC companies surveyed for this study find it challenging to grow revenues online, due to difficulties in finding talent, securing employee and management buy-in, and gaining the knowledge on how to leverage the Internet. This in part reflects the region’s limited ICT skill levels. Consumers meanwhile are concerned about online fraud and ability to deal with shipping costs of items ordered from overseas.

New Policy Toolkit to Catalyze Digital Trade in LAC

All LAC economies benefit from digital trade, but barriers still stand in the way. LAC governments need to adopt a new trade policy toolkit to remove them. This toolkit needs to cover all familiar aspects of trade policy – trade regulations, trade facilitation, trade-related capacity-building and export promotion, export credit, and trade infrastructures – and re-tailor them to meet the challenges of the digital era. Some key ideas to bolster digital trade in LAC include:

IMPROVE THE POLICY AND REGULATORY ENVIRONMENT FOR DIGITAL TRADE AND ECONOMY

Regulatory frameworks need to be upgraded to the digital era, to help small businesses leverage existing cross-border platforms. Some key measures include:

- Create or modernize safe harbors from liability - intermediary liability protections are already present in Chile and Brazil.
- Update copyright laws to include limitations and exceptions such as fair use.
- Limit over-regulation of online services and application of legacy infrastructure regulations to online services, such as extending telecommunications or broadcasting regulation to messaging applications or streaming platforms.
- Implement flexible data protection regulations that focus on improving security rather than limiting the use of data.
- Promote cross-border data flows and interoperable policy frameworks that enable LAC firms to do business across borders.
- Create balanced consumer protection laws to bolster consumer trust in products and services sold online, delivery systems, online payments, and other online services.

ENSURE SECURE AND FLUID ONLINE PAYMENTS

Online payments are critical for online trade. Positively, online payment platforms have proliferated worldwide, helping new online sellers get started. However, LAC economies need to address two major challenges – still scant adoption of online payments by companies and consumers, which can be rectified by control of online fraud and consumer education about the relative safety of online payments; and the lack of interoperability among the various payment platforms, which can be bridged by technical solutions and revised national financial regulations.

FOCUS ON TRADE FACILITATION FOR SMALL ONLINE SELLERS

Customs regimes and Trusted Trader programs that fast-track trade through customs are still tailored to the patterns of traditional trade – large, regular trade volumes shipped by large companies – rather than accommodating small enterprises and consumers, whose trade is more sporadic and who are ill-equipped to comply with complex trade rules. To change this, LAC governments can build upon the successes of the Exporta Fácil program as follows:

- Build “Trusted eTrader” programs for compliant small online sellers to move their goods through customs quickly and affordably.
- Ensure a “single window” approach for one-stop compliance, collection and remit of taxes for goods that are above the de minimis level from away from the border; and paperless trade.
- Stimulate trade in the hallmark of ecommerce, low-value items such as small parcels, by raising de minimis levels. This can be best done via a plurilateral agreement on de minimis, whereby every country gives some market access to low-value shipments from others, while every country gets a great deal of new access for their low-value exports.

BRING DIGITAL PLAYERS TO PROVIDE TRADE FINANCE IN THE DIGITAL ERA

The global trade finance gap stands at \$1.6 trillion, most of it affecting small businesses. While export credit solutions offered by banks, with backstopping from export credit agencies and multilateral development banks, are still critical, the digital revolution opens opportunities for new solutions especially for small online sellers. These players often need much smaller and faster working capital loans than banks want to issue, particularly given the heightened know your customer and anti-money laundering rules, counterparty risks, and Basel III capital requirements. . LAC export credit agencies

should work not only with banks, but also with the many online lending platforms, to guarantee the issuance of pools of small export working loans to online sellers. Governments can also support supply chain finance solutions for online sellers to improve their cash flow and thrive in global value chains, by working with online lending and ecommerce platforms.

CREATE PUBLIC-PRIVATE PARTNERSHIPS FOR ECOMMERCE EXPORT PROMOTION

Governments and companies share an interest in expanding digital trade in LAC. Yet trade capacity-building as it has been known won't suffice. Export promotion agencies are unlikely to have the best technical know-how about cross-border online selling or purchasing, or about leveraging technologies to optimize digital sales opportunities. Again, public-private partnerships are critical; for example, LAC governments can recruit and support ecommerce platforms to provide training to online sellers. As done by Costa Rica, they can also help aggregate online sales channels for small businesses to have a one-stop online shop reaching buyers on many platforms.

BUILD A TRADE INFRASTRUCTURE AND BUSINESS ENVIRONMENT FOR "NEW TRADE"

LAC economies need to improve the overall infrastructures and business environment for the digital era. At the most basic level this means building 21st century IT skills, furthering connectivity and broadband penetration rates, enabling small companies to compete in the digital economy, and helping analog companies digitize. It is also critical to improve innovation policies and cutting of red tape miring digital businesses and entrepreneurship.

WORK REGIONALLY

Building on decades of trade and regional integration, LAC countries can set out to learn from each other's experiences in creating the enabling environment for digital trade, and develop joint solutions for digital trade to flow. They can also create common regional regulatory and policy frameworks in such areas as free circulation of digital goods and services, privacy, consumer protection, cybersecurity, taxation of digital companies, and others to help lower the costs for companies to operate across the regional market, incentivize investment and startup formation, and fuel the expansion of digital networks and services. The Pacific Alliance has taken very positive steps in this direction.

LAC's digital trade agenda ahead is challenging and exciting, with many great further opportunities for entrepreneurship, growth, and job-creation.

There is also no turning back: LAC governments must step up for their economies to compete and prosper in the 21st century digital economy, and support the many regional companies that are driving the region to the digital era.

Importantly, the modus operandi for designing policies needs to be more inclusive than ever. Given that the private sector is closest to the problems to digital trade and solutions to it, optimizing the enabling environment for digital trade cannot be done by government fiat, but via informed, multi-stakeholder dialogue and ideation among entrepreneurs, corporations, academics and the government.

There are also significant opportunities for public-private partnerships in such areas as export promotion and export credit.



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