
LAWRENCE BURNS TALKS TO PEDRO ARNT, CHIEF FINANCIAL OFFICER OF MERCADOLIBRE

The value of an investment, and any income from it, can fall as well as rise and investors may not get back the amount invested.

Lawrence Burns (LB): I think the first thing is just to thank you both for coming up to Edinburgh and being willing to do this.

Pedro Arnt (PA): No. It's a pleasure to be here. Always interesting hearing from the Team from Baillie as well.

LB: You've left summer in Uruguay to come to Edinburgh in the depth of winter, so I think that deserves extra credit.

PA: Thank you.

LB: I think the starting point we're trying to ask in these series really is just trying to ask what is the problem that MercadoLibre is actually trying to solve?

PA: In many ways, it's encapsulated in our mission statement, of democratising commerce and money. How can we apply technology to the retail and banking industries to broaden accessibility, to improve service and to lower the cost to serve. So we're making products available at a scale that wasn't occurring before for Latin American consumers. We're helping Latin American merchants reach hundreds of millions of consumers that otherwise they wouldn't be able to reach.

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And on the financial side, and this is potentially I think the one that excites us the most, we really are at the forefront of driving financial inclusion that, ideally, will better the lives of hundreds of millions of Latin Americans, by giving them access to credit, by giving them access to financial services and by helping them to better organise their financial lives.

LB: And do you think the societal benefits of that mission statement, of democratising commerce, democratising access to financial services, it's more meaningful in a continent like Latin America than we might think of it in the UK or the US?



PA: Absolutely. And I think it goes both ways. The impact, I think, of the mission is larger, but in many aspects easier, in that the more inefficient a market is, I would argue the easier it is to generate significant value for consumers, and to therefore gain consumer preference through technological innovation.

LB: And you joined MercadoLibre in its founding year, so over 20 years at the company. Just curious, if we go back to 1999, what was it that originally attracted you to MercadoLibre?

PA: It's been a while, Lawrence. It's been 20-plus years. In the late 90s, I was working as a consultant at BCG in São Paulo and Buenos Aires, and I recall we were doing a lot of work for the large telco companies, trying to help them figure out what they should be doing with this new technology called the Internet that was around.

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And it was interesting, by mid-99, most of us at that BCG office in Buenos Aires realised that this was a generational opportunity, but at the same time that these large telcos, our clients, were not built or equipped to actually capture that opportunity. So literally something like 60% of the office quit at some point between June and October 99 to go start their own consumer internet companies or enterprises.

And our vision, at that point, was to ride that consumer internet wave. But there was something else that attracted me to the way that Marcos and my colleagues at MELI were approaching this, which was most of us had been studying abroad, and we had always had this sense that we, as Latin Americans, felt completely at the same level as most of our European, North American and Asian colleagues or fellow students, and yet when we looked at Latin America, we didn't really see that many companies that had emerged from the region and had become relevant at a global scale, on a global level.

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And so part of what attracted us to building MercadoLibre together was not just the opportunity of disrupting retail and then, eventually, disrupting finance, but let's build something out of Latin America that is on par in terms of the way it's run, and the global impact it can have, as many of the multinational companies that typically came to dominate the region.

LB: I suppose you would have joined just before the dot-com bubble. Did that change the confidence of the long-term mission, or make you doubt it at that point? Or was it more this is survival mode, we need to get through this, get the capital and we know this project will still work in the long run?

PA: I don't think we ever waived in our conviction that the project could work. I think there was an element of luck and an element of capability. We closed about a \$50 million series B or series C, I don't remember it right now, right around the right timing, so just when the market closed. That left us fairly well capitalised to go through the desert.



And I think there were some characteristics about our team that made it easier. Most of us really believed in the transformational power of technology. We hadn't joined that internet wave to become millionaires in a year and then get out and go do what we really wanted to do. Many of us that are still leading the company have been around for the full 22-year ride. And so that made it easier to retain talent and to stay committed through that desert we had to pass, 01, 02.

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So we didn't think it would take this long for consumer internet to become mainstream, but the vision and the conviction that it would happen, I think, was always there in the core team.

LB: When I was in Montevideo and you were kind enough to see us in the summer, I actually showed my colleagues, Helen and Tom who were with us, that one of the founding photos, at least that's on the Internet, of the team, and what's remarkable is so many of the people are still there or involved in some way or another. And I think that does show the stability of being builders.

Today, in the core businesses, you've got commerce, you've got finance. On the e-commerce side, that's been a global story, as you were alluding to, over the last 20 years. Online sales, today in Latin America, are probably somewhere around 11%, give or take. That might compare to, say, 30% here in the UK. I'm just curious, how do you think about the scale and duration of the e-commerce opportunity from this point onwards?

PA: We're still very optimistic. There's this wonderful Bezos concept of the day-one company, and I think in many ways MercadoLibre still is a day-one company, not only in the way that we try to run it but the fact that our markets still allow for that kind of day-one mentality and day-one opportunity. I think you laid out the numbers quite well. It's still early-stage for e-commerce in Latin America.

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And we really believe that, in many ways, we sit on the levers to continue to unlock that shift from offline to online. We still believe that a lot of the friction is still supply-driven.

So as we are able to bring on more inventory and more merchants, as we continue to build out the logistics that make it faster and cheaper to get those goods from warehouses or from merchants to consumers, and as we continue to improve the technological interfaces and experiences, we are able to unlock a lot of what eventually drives online retail penetration from high single-digits, low-double-digits, where it is today, more towards developed-market levels.

So certainly the opportunity is there, and it's very much in our control to unlock that opportunity, which is a privileged position to be in from a business-building position.

LB: And if we go back to 1999, the original vision was something akin to eBay, eBay was the inspiration, and for most of its history it's been very different from eBay. It hasn't been about second-hand goods, it hasn't been about auctions and so on, but that constant evolution, which



you're still going through today as you move into groceries, as you're thinking of different ways to address the consumer and even the base of the pyramid, how important is it to not have a static model of what commerce should be and to continue to innovate and evolve in this space?

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PA: And I think, Lawrence, that is the key question. The most important thing at MercadoLibre is how do we make sure that we continue to innovate constantly? I'd say there are two types of innovation that we need to constantly push. One, which is, to a certain degree, the one you're alluding to, how do we continue to innovate on our existing core businesses where we are already leaders, how can we continue to improve our commerce business, how can we continue to improve logistics?

And logistics is a great example. Like you said, for the first 15 years of this company, actually touching physical inventory was anathema to us. A lot of what we initially had built was that purely asset-light model, where the beauty of it was that we never touched inventory, we never touched products.

I think we recognised, about six, seven years ago, that logistics was going to be a critical piece to the user experience, and therefore we had to go all in in logistics. Which was daunting, it was scary for us, but we did so, and today we run the most efficient e-commerce logistics network in Latin America.

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And then the second piece is we need to continue thinking what are the new avenues of growth, what are future growth engines that make sense because they're very synergistic with the existing business but that generate new opportunities for MercadoLibre.

And the final thought on this is I'm convinced that part of our success is that we've actually found somewhat of a repeatable model for innovation that de-risks a lot of the new things we approach. So it's not simply chaotic innovation but there is method to it.

And I'm going to grossly oversimplify here but I think it goes somewhat like this. First of all, we need to identify something where we think the addressable market and the opportunity is large enough that it makes sense to take the risk of trying to build a business around that.

The next steps are the ones that get interesting, because when I look back at all the things we've launched, there is a certain repeated process to it, which is, first of all, launch rather quickly with a product that we know is not really necessarily market-ready yet, but launch it on the marketplace to a limited number of users. And then start iterating based on the feedback that we're getting from those consumers.

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Phase two is start expanding that to a larger percentage of on-marketplace users. Eventually, you've iterated enough and you've gotten enough feedback and, most importantly, you have



enough scale that your cost structure is now competitive. Then, move that off-platform and start offering it in the open market, and then build from there.

And we've done that with most of the FinTech products we're launching, we're beginning to trial that on logistics, and in general I think that's what we'll do going forward every time we think of entering a new vertical or a new industry. And it significantly de-risks the innovation process and it allows us to kill things that aren't working way before we've over-allocated capital actually trying to build that out in the open market.

LB: When I was in Latin America in 2018, meeting yourself and Marcos, he was quite clear that the one competitor that really keeps you up at night is Amazon. I suppose what's interesting within Brazil is they've been involved and investing and operating in the region in different forms for quite a long time, they're not actually one of the major players, I suppose, in terms of share. Why hasn't it yet quite worked out for Amazon in Brazil? And how do you think about the elements that could change to enable them to work out, and effectively therefore how do you pre-empt that and limit their ability to manoeuvre in the country?

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PA: I think part of the reason that we've always seen them as perhaps the most relevant competitor, and Brazil is potentially the most competitive ecommerce market globally right now, is because of the long-term approach they take. I think potentially we're the only other company that thinks as long-term as they do. And the reason I say that is this is far from over in terms of that competitive dynamic.

Now, on a more optimistic note, if we look at everything that's happened from that 2018 conversation you had with Marcos to today, I think we've held up incredibly well competing against potentially one of the most formidable companies to have emerged in the last 200 years.

And I think, to answer the specific question, that market structure is complex in Latin America. To gain access to those potential 650 million inhabitants, it's not one country, it's not even a single market. It's multiple, smaller markets. And then, when you go into each one of those markets, there are particularities, not just the fact that Amazon was entering Brazil where there were already large, entrenched incumbents, ourselves being one of them, but there are particularities around logistics and geographical reach. The credit environment is quite unique to Latin America.

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So there are many things that don't just make the Amazon playbook applicable almost as a replica. I would argue the US and Europe have much more of just replicate the working playbook. So all that, what we like to call, topicalization of the business model is not necessarily that easy if Latin America is not a core market for them as it is for us.

And then we've, I think, also done our part in terms of identifying what our weak spots were. I think logistics is one that clearly comes to mind, and over the past five, six years, we've built logistics capabilities that I don't think anyone would have envisioned us being able to build



five years ago. What we've done on the credit front, what we've continued to do on the payments front, and I think the interaction between payments and commerce is much more relevant in emerging markets than developed markets.

So there are many things that I think leave us optimistic in terms of competitive dynamics going forward, even with the most fearsome of competitors like Amazon.

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LB: I think what was helpful for us, as a data point and validation, was also Amazon's entry into Mexico, where they were going to work it and make it succeed in one market in Latin America, it would be Mexico, given the overlap, its geographically contiguous nature and so on, and being part of NAFTA.

You also mentioned logistics there, and I suppose six or seven years ago, you didn't really have that much involvement on the logistics side, you were a software business, and you had to learn a very different type of business. And you seem to have done that, actually, as you were alluding to, remarkably well.

80% of deliveries within 48 hours across Latin America is a real achievement. How have you been able to develop that expertise in a very new and very different area, and execute it in a way that... I see the logistics platform you've built today, it's not just fast but it's scalable, it's economical. And it had its biggest test of course through the pandemic period as well.

PA: And I think that team is probably the team that deserves the most recognition internally in MELI, because what they have built over the last five years, starting from scratch, is truly phenomenal. And like you mentioned, to have done that and to have been able to cope with the significant surge in demand that occurred throughout the pandemic is really, really a tribute to the way they've executed.

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And there are probably a few components to that. The first one, and this is fantastic because I think this really is a proof-point of what we've tried to build as a company, we approached logistics with a very keen eye on technology. So we didn't just say, let's hire a whole bunch of people from the logistics industry. Obviously, we've taken on a lot of industry expertise, but when you look at the core engineering team, most of those were people that were already with us and didn't have prior industry knowledge.

So much of that network is optimised, and the efficiency that you were talking about is driven by technology, software, algorithms on the backend. I remember this critical point where we had to decide do we hire existing, best-in-class software out there for the logistics industry, for routing, for warehouse management systems, or do we build our own from scratch. And at the end, we decided to build from scratch, and it was probably the best decision we could have made.



And then the second piece is that I think we've also built a lot on our own, but we've also hired people away from the FedExes, the DHLs, even the Amazons of the world. Coupang, we've brought people in from Asia. So we've always, I think, been quite good at understanding that you can accelerate your learning curve from learning from others who have done it before. And I think we've been fairly okay with combining building from scratch for our own necessities with copying what has worked elsewhere.

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LB: For me, observing it from the outside, it has been a remarkable transformation. And I think in the context of when I was first looking at Latin America and Brazil's delivery, the idea of 80% within 48 hours would have been almost like a dream. Everyone used Correios, the national postal service. That was consistent in the sense that it struck every summer, which caused the entire industry a headache.

I remember one of your major competitors, a number of years ago, was actually banned from operating for a period of time in the state of São Paulo because the deliveries got so late. So I think to have moved to that stage is really, really impressive. And I think visually, I don't know how you feel about this, when I see the images of the MercadoLibre planes in yellow with the logo, that is quite a transformation.

PA: It is, and it's interesting, I think the planes are very emblematic of how far the logistics organisation has come in a fairly short period of time. And quite honestly, I think if you had asked us five years ago, will you be running MELI Air, much in the same way Amazon runs, I think it's called, Prime Air, I don't know what it's called, in five years, the answer would have been absolutely not. And yet, we've been able to iterate and innovate at a pace where, quite frankly, we've gone much further than even we had envisioned five, six years ago.

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LB: I remember when you were working out what you wanted to do in logistics, that it was, if you don't mind me saying, both a very thoughtful but also very long process. You didn't jump to we're going to do this, it was a lot of thinking, if we're going to have anything that's going to be asset-heavy, we want to be very cautious about how we do that and change the profile of the business.

A lot of companies really struggle when they start out with a very neat software solution and they need to build the hard infrastructure, because the financial profile is just radically different. You've got to invest quite a lot upfront. Over a period of time, you basically trash your financial model in terms of cash flow. How difficult was that for MercadoLibre, and also for you as CFO, to make that decision to be willing to change the financial profile of the business?

PA: And change it we did. But surprisingly enough, Lawrence, it wasn't that difficult. And I think there are a few elements there. First of all, we talked about this earlier in the conversation, we really approach our business with a long-term view. And I think it had become very clear to us that controlling logistics, although it wasn't a necessity back then, was going to become a



requirement for the business to be able to thrive over the long run.

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Because someone was going to push the boundaries and get to 48, and we're actually now getting to 24 and even same-day delivery, and we could either decide that that someone was going to be us, or leave it to someone else to do. So I think again, as our competitors, as Amazon, say, if you build back from the consumer, it was painfully clear to us that that was going to be a necessity.

And because we approached the business long-term, and I think founder-led businesses also... The enormous advantages of Marcos still being the CEO as well as the chairman and incredibly involved, is that I do think founder-led companies find it easier to dramatically change their financial profiles, because of the credit that's been built, and also a management team that's been around since the beginning.

Now, to not just give us the credit, I also think we were fortunate in that the market backdrop was supportive. So it would have been a more difficult, I think, change in business model were we to try to pull that off standing here today in late 22 than when we did it in early 16. And I think sometimes timing and context are also part of success stories.

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LB: And obviously Amazon are a competitor, but that's also one of the things that were presumably done that was quite helpful for showing investors, look, if you invest very heavily, you can reap the long-term rewards. And that made it easier because they were presumably doing a bit of pattern recognition and going, actually, we think this will be okay.

PA: Absolutely. I think they did a lot of the investor education and investor convincing for us. And also, to my previous point, it was very easy to point out, look, either we do this or eventually they will. They might take ten years, but they will come to Latin America.

LB: If we move on to the other half of the business, FinTech, it's been born out of a payments app, allowing people to pay online when you've got low credit and debit card penetration, and also the credit and the financing element. I've always been struck, when I first looked a Brazil, you go online to buy something, it might only be £5, £10, but there'll be the offer to buy it on credit and instalments, which is a very different dynamic.

And you've moved into credit, savings and investments and loans. Latin America's always seemed particularly ripe for financial disruption. Can you just talk a bit about what the nature of the market is that makes it even more attractive?

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PA: The underlying, I guess, metric is the percentage of the truly banked population. And the numbers sometimes are misleading because many people have a banking relationship but with extremely limited access to services from those banks. Or, quite frankly, in many cases, if



you're not a profitable consumer or a higher-income-demographic consumer, very poor service.

And so there's this enormous pent-up demand for financial services by Latin Americans, both on the consumer side but equally interesting on the small business size and the micro business size and the medium business size. So it's a classic example of pent-up demand.

What allows, I think, that thesis that, as you say, has been there for the longest time, to actually play out now, again, is technology. The way that technology dramatically changes the cost to serve is what makes it possible to now pursue those literally hundreds of millions of Latin Americans that are absolutely clamoring for a financial services relationship and simply weren't getting one from the incumbent banks.

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You overlay that with the fact that we already have relationships with tens of millions of Latin Americans because of our retail business, and the amount of data that gives us and the ability to then underwrite those products for those consumers, I think placed us in a position where the opportunity was there and we had quite a distinct set of capabilities and assets to be able to capture that opportunity. And that's what Mercado Pago is quickly becoming, I think, a de facto digital bank for the under-banked and un-banked throughout the region.

LB: And how tricky has it been? You've built a very successful commerce business, the rules in e-commerce are very different from the rules of doing financial services. Not only is the latter highly regulated, but it makes some degree of logical sense, given the network effects and scale in e-commerce to go and have losses and build up that scale. The risk profile in finance is very different.

How culturally difficult was it, and the challenge of making sure that the teams of commerce and FinTech had quite different subcultures, I assume, and different KPIs, different incentives, different approaches.

PA: It was challenging, and I think it still is challenging. We've, I would almost say, over-acted and been very, very deliberate about setting up, at times, even somewhat artificial constraints on some of the FinTech businesses. And even within FinTech, it's very different, I suppose a culture of growth-focused mentality similar to the e-commerce business is not that risky.

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Now, when we start getting into things like asset management or particularly credit, you completely need to change that chip, because it can't be growth first. It has to be growth only at the right risk profile, and also recognising that our ability to identify risk, we haven't been at this for that long, is also somewhat limited. So we've been very deliberate at building those guard rails and communicating those guard rails very clearly. You should not lose money on the credit business. You want this to be a profitable credit business.

Or you need to fully fund your credit book by 2023 on your own, because the rest of the



business doesn't want to continue to have to put up the equity for the growth of the credit business. So these artificial guard rails, that if you triple-click potentially wouldn't make too much sense but that were necessary to be able to generate those distinct cultures within a single organisation, where some elements of the culture, innovation, taking risk, moving quickly, you need to maintain.

LB: And we've touched on it a few times, and I think it's quite clear in the conversations we have had in your team that you care quite deeply about it, and see it as very aligned with how do you become commercially successful? Well, as we were saying at the beginning, you solve a problem. But any background on how you think about how important MercadoLibre is in actually driving financial inclusion in the region?

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PA: It's absolutely a key player in driving financial inclusion. Because of our pre-existing first commerce business but then also the payments business, we have this unrivalled distribution capacity. And a lot of that is exactly in those segments of the population that are most demanding of financial inclusions. We already have relationships with them, so we will be a central player in financial inclusion in the region.

And fortunately, that's something that has been quite recognised by regulators as well. When I think of our relationship with regulators, so much of that back-and-forth is, I think, permeated by their understanding that if well-executed and with the appropriate level of oversight, this could be a tremendous force for good in terms of driving more financial inclusion.

LB: And that cost to serve point, what really stuck out to me about that is you think of how many people across the region would want and benefit from, you can choose different numbers, a \$20 bit of credit, \$50, \$100, \$150 credit, but a lot of the time we talk about disruption, and there is an element of disruption but there's also an element of actually growing the market in the first place. Which, again, presumably is quite helpful to regulators, saying we can be really helpful even without massively damaging the existing banking infrastructure, but just by growing that pie.

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PA: And that's the case. And I think the media in some markets have made a lot about Mercado Pago versus the banks. And if you look at that today, that's simply not the case. Fast-forward ten years, I think eventually we come up against each other, but if you look at even the potential size of our credit books, it's still just a drop of water in the ocean. And not just consumers.

When you think of that again on the merchant side, you look at small and midsized banking, it's been an extremely difficult value proposition for banks, because visibility into those businesses is very limited. Cost to serve is very high.

For us, visibility is full. We're processing payments for them, we're helping them sell online, so we're seeing their businesses real-time, we're interacting with them digitally. So it's on both sides of the banking business, consumers and merchants, where it's complementary to the



existing industry and definitely it's enhancing the size of the market, not zero-sum game where we're competing for the existing market.

LB: Do you ever consider what will Latin America look like if MercadoLibre succeeds? How will it change, what will it look like? Because the scale of what you're doing is such that I think that question is relevant.

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PA: Yes, it's humbling that it's relevant. Because my initial instinct is to say we're not changing a continent, but then when I think of the sheer scale of what the teams at MELI have built, we're probably beginning to inch up on 150 million Latin Americans that interact with us on an annual basis, that is something that could potentially change the face of a continent.

So when I think of that, and again there are still day-one elements of what we're building, I can clearly see a path where that 150 become 300, and the remaining 300 to get to 600, a lot of the work that we're doing, and we've talked about this in the past, is how do I get to a logistics model that is slower but so much cheaper that I can actually access those last 300 million Latin Americans?

And then the same with FinTech, I think we will have to figure out what the right products might be for those consumers, and it could end up being just helping them with financial literacy and how to better manage their existing cash flows. So when I put all that in, I think our vision is can we help give all these consumers access to goods and services in a way that would have been entirely unthought-of prior to the digital revolution? Can we help them also gain financial inclusion, and therefore can we be a driving agent in closing that digital divide?

Because it's obvious that for the top 50 million Latin Americans, technology will dramatically change their lives. The big, big challenge here is how do we make sure that we can also deliver all those benefits to the other 500 million. And I think MELI will have a huge part to play in that challenge.



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Baillie Gifford International LLC is wholly owned by Baillie Gifford Overseas Limited; it was formed in Delaware in 2005 and is registered with the SEC. It is the legal entity through which Baillie Gifford Overseas Limited provides client service and marketing functions in North America. Baillie Gifford Overseas Limited is registered with the SEC in the United States of America.

The Manager is not resident in Canada, its head office and principal place of business is in Edinburgh, Scotland. Baillie Gifford Overseas Limited is regulated in Canada as a portfolio manager and exempt market dealer with the Ontario Securities Commission ('OSC'). Its portfolio manager licence is currently



passported into Alberta, Quebec, Saskatchewan, Manitoba and Newfoundland & Labrador whereas the exempt market dealer licence is passported across all Canadian provinces and territories. Baillie Gifford International LLC is regulated by the OSC as an exempt market and its licence is passported across all Canadian provinces and territories. Baillie Gifford Investment Management (Europe) Limited ('BGE') relies on the International Investment Fund Manager Exemption in the provinces of Ontario and Quebec.

Israel

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