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## CHALLENGES FOR LOGISTICS TECH STARTUPS IN THE SINO-BRAZILIAN E-COMMERCE MARKET: THE CASE OF BR EXPRESS

### Desafios para *startups* de tecnologia logística no *e-commerce* sino-brasileiro: o caso da BR Express

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#### Abstract

Cross-border e-commerce is a modern phenomenon that has been growing fast. China, as the global e-commerce market leader, is exporting a large quantity of consumer goods abroad at attractive prices and in great variety. Although the Sino-Brazilian e-commerce market is growing fast, however, only the state-owned postal service company (Correios) has the privilege of a tax exemption, thus holding back the cross-border e-commerce market from being developed by logistics tech startups. This teaching case details the challenges in the logistics industry in Brazil and suggests discussions for logistics tech startups.

**Keywords:** Cross-border e-commerce, logistics tech startups, market expansion.

#### Resumo

O comércio eletrônico transfronteiriço é um fenômeno moderno que vem crescendo rapidamente. A China, líder global do mercado de comércio eletrônico, está exportando uma grande quantidade de bens de consumo com seus preços atraentes e grande variedade. Embora o mercado sino-brasileiro de e-commerce esteja crescendo a um ritmo sem precedentes, apenas os Correios (empresa estatal) têm o privilégio de isenção fiscal, bloqueando o caminho para o desenvolvimento do mercado por startups de tecnologia logística. Este caso de ensino, por meio da BR Express (nome fictício), elabora os desafios no setor logístico no Brasil e propõe discussões gerenciais e estratégicas para as startups de tecnologia logística.

**Palavras-chave:** E-commerce transfronteiriço, *startups* logísticas, expansão de mercado.

#### BR Express: Background and business strategy

BR Express is one of the most competitive players in the tech startup market with its typical sharing economy business model. Positioning itself as a technology company for reinventing last-mile logistics in Brazil, BR Express was established as an online platform that allows users to connect directly with freelancers, who are mainly motorcyclists, with the concept of using urban logistics to expedite express delivery services in cities where traffic is busy. Within a short period of time, the exponential increase in customers has demonstrated that demand for express delivery solutions exists, and further accelerated the offer of other new services for e-commerce platforms, including national delivery. At present, although BR Express serves all the main national e-

commerce platforms, its ambition has gone further. Anticipating the great potential of market growth, the company has planned to build a cross-border solution for international e-commerce platforms, mainly from China. The solution it created was based on the following assumptions:

- The logistics services in the Brazilian cross-border e-commerce market are either of low quality or high cost, and lack an affordable high-quality solution.
- Correios' DDU solution resulted in frustrating customer experiences, and customers are willing to pay more for a positive experience with a DDP solution.
- BR Express's solution is highly competitive in the high-ticket products in relation to Correios and traditional private couriers.

First, with its innovative, sharing economy business model, like an “Uber” for “items”, BR Express has cut many of its labor costs by outsourcing the last-mile service. Its technology also enables it to optimize the operation and reduce costs through AI machine learning in customer services, automation in its operations, and digitalization in the delivery process. In the last few years, continuous venture capital investments have made it possible for it to offer a cross-border solution at a very competitive shipping price, which helps differentiate it from the major private couriers and enables it to compete with Correios.

Second, its high quality service, including fast delivery times and a hassle-free customer experience, can also differentiate it from Correios and make it competitive with other private couriers. The tax payment method that Correios is using, which is Delivered Duty Unpaid (DDU), is a method for collecting taxes directly from the final recipient when their shipments arrive at the customs. This may delay delivery because the payment is not made, or because of resistance from consumers to pay the tax at all. Private couriers are also using this method, but the difference is that they pre-pay taxes and only collect from their customers afterwards, which transfers the risks to the couriers but ensures delivery on time, although it can still frustrate customers who have to pay a subsequent amount. Relatively speaking, BR Express's Delivered Duty Paid (DDP) solution is a method that allows the taxes on imported items to be pre-paid by consumers at the point of check-out. By collecting the information beforehand, it makes for more transparency and certainty and guarantees express delivery.

In other words, BR Express's solution offers an optimized cost-performance ratio, with a high-quality service at an affordable price. Even though there is an extra cost because of the high taxation, the import tax exemption enjoyed by Correios has a threshold of US \$50 under some conditions, and does not apply to all products. BR Express can be competitive in high-value products where all players operate under the same regulations.

### **BR Express's initiative**

Eduardo, the sales director, and his team have spent the last seven months prospecting potential clients. The company contacted 75 Chinese e-commerce sellers, including major e-commerce platforms, top sellers on the platforms and local Chinese sellers. Of the 75 companies, 63 were reached but most of them preferred to maintain their current shipping options, or showed little interest after hearing the taxes. Another 17 sellers showed interest in BR Express's solution and attended meetings to negotiate the deal. In the end, only two sellers moved on to a pilot scheme. The major cause for the sellers' reluctance to sign up was the high taxes, because the DDP solution will not allow them to under-declare the value of the goods. The two pilot customers also put their collaboration on hold after some weeks, and have showed no intentions of “going live”. Of these two pilots, one exhibited BR Express's solution on the hot-sell commodity pages of its store in the marketplace, but it had only one conversion in two months. The low volume of orders resulted in higher shipping prices and slower delivery times. Therefore, the unsatisfactory results forced the whole project to be put on hold. Apart from meetings, Eduardo also personally visited the customs

clearance operation site and observed the import process live as he tried to understand the reasons behind the customers' resistance to adopting the new model.

As a result of the above, the management of BR Express is discussing whether they should keep this initiative and what strategies they should adopt to be better prepared for cross-border challenges in the light of the results achieved so far.

### **Business opportunity**

In the past few years, with the growth of internet users in Brazil, the Brazilian e-commerce market has been enjoying a boom. E-commerce users in Brazil constitute a significant segment (60.5%) of the total population, numbering 127.7 million people, with revenue in the e-commerce market amounting to US \$15 b (Statista, 2019). Nowadays, cross-border e-commerce platforms have also become an incredibly significant channel for Brazilians to consume. Approximately 81% of Brazilian online consumers have made an international purchase, mainly from China (63%) (UPS, 2018). Besides the largest Chinese e-commerce website AliExpress, which belongs to the Alibaba group, the two largest e-commerce outlets in Brazil, Mercado Livre, and group B2W, are also running a cross-border operation selling products in Brazil that are imported from China.

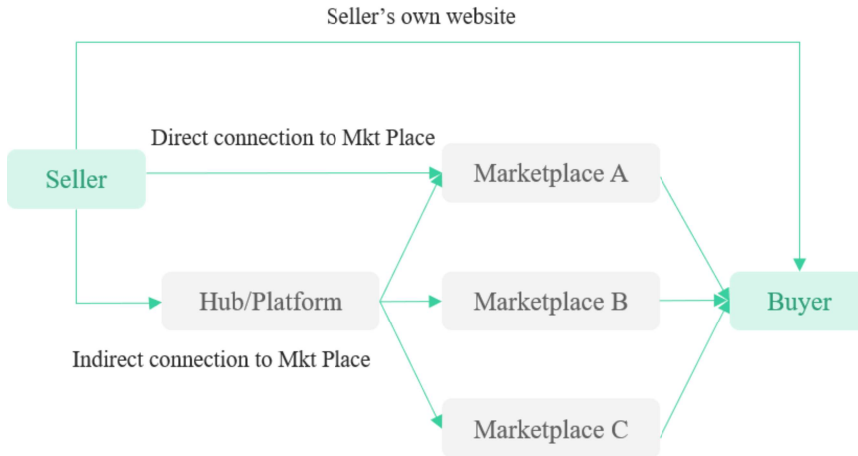
It is not surprising to see that China has become the origin country with the largest cross-border packages for Brazil. In the past decade, as the largest global e-commerce market player, China has enjoyed rapid growth in its cross-border e-commerce, and continuously enlarged its capacity to manufacture a great variety of consumer products for export to the world. On the other side, Brazil has been one of the most important cross-border e-commerce destinations for Chinese products. In 2018, the Chinese e-commerce export trade reached around US \$1 trillion, mainly selling electronics and fashion products to the United States (17.5%), France (13.2%) and Russia (11.3%), followed by the UK (8.4%) and Brazil (5.6%) (ECRC, 2019). Compared to the relatively mature American and European market, Brazil has showed great vigor and potential as an emerging market, which has attracted the attention of Chinese cross-border e-commerce sellers more and more.

Although the Sino-Brazilian e-commerce market appears to be promising, the inefficiency of the logistics system in Brazil, such as lengthy delivery times and hefty import tariffs, remains a huge roadblock, and this may hurt Brazilian consumers' willingness to buy, and deter international sellers from entering the Brazilian market. B2C cross-border e-commerce logistics solutions are subject to a system that depends heavily on the state-owned postal service company (Correios) and on traditional private couriers (DHL, FedEx, UPS, TNT), which are either inefficient or very costly. As a result, although there are numerous Chinese sellers and marketplaces that are attentively observing the changes in the Brazilian market and seeking to enter it, they are still holding back due to the great uncertainty. Meanwhile, the logistics operators have realized that they must innovate to offer a more efficient delivery service to the cross-border e-commerce market. In addition to the existing major players, some regional technological logistics startups have also been ambitiously trying to become competitors in the past few years. Their new business models and technology applications might help them differentiate themselves to capture the "white space" in the market. BR Express, for example, has assumed that logistics services for Sino-Brazilian e-commerce are polarized, and that there are opportunities in between, which is an affordable high-quality express delivery.

### Brazilian e-commerce models

According to J.P. Morgan's Latin America Equity Research (2018)<sup>1</sup>, the Brazilian e-commerce ecosystem has three major patterns, as illustrated in Figure 1:

Figure 1. The Brazilian e-commerce ecosystem



Source: J.P. Morgan (2018)

In the first model, the seller sells directly to consumers through its own website, such as Renner and Dafiti. The second model is the seller selling its products via a platform that operates as a middleman, such as Mercado Livre, B2W and AliExpress. The last one is the most indirect model, but can be very convenient for the sellers to manage multiple channels and marketplaces, since a hub/platform is used by the seller to integrate various marketplaces, thus guaranteeing inventory and price consistency. An example of this is Rakuten, a hub for key marketplaces and a logistics platform. The most widely-used model in the Sino-Brazilian cross-border e-commerce market is the second type, with many small Chinese sellers selling through large marketplaces to Brazil.

The research by J.P. Morgan (2018) also showed that over the past few years, marketplaces have been gaining an increasing share of the total e-commerce market, with positive feedback coming from Brazilian customers, mainly because of the lower prices and great variety.

### Current competitors in the market

#### *Correios*

Since the 1990s, Correios has been committed to modernization and technological innovation. At present it is the largest player in the cross-border e-commerce market, thanks to the government's preferential tax policies it enjoys. In recent years, however, due to the rapid development of the e-commerce market, the soaring volume of packages has also put Correios under great pressure. Meanwhile, its overstaffed organizational structure, outdated policies and frequent labor strikes have led to rising operational and labor costs resulting in financial losses and a continuous rise in its shipping prices. Correios is expected to be privatized within two years, as indicated by the Brazilian Ministry of Economy, with eight companies currently interested in acquiring it.

<sup>1</sup> J.P. Morgan. (2018, June 15). *Brazilian E-commerce X-Ray: Strong Secular Growth, Dominated by Marketplaces*. Internal Latin America Equity Research Report. Unpublished..

### *Private couriers*

In the cross-border market, the major players are DHL, FedEx, UPS (TNT was acquired by FedEx in 2016 in Brazil), which are well-known as the top three private global couriers. They are private firms that provide courier services for shipping parcels or important documents, and cover an extensive number of destinations worldwide. DHL was founded in the US and is currently part of German Deutsche Post, which was founded in 1969, and that specializes in international express delivery shipments with a very broad global presence. FedEx, an American company founded in 1971, is the strongest competitor of DHL, known for its overnight delivery service and time-sensitive air shipments. It is similar to UPS, another American company founded in 1907, which also provides express delivery worldwide and is well-recognized, and especially strong in ground shipments. The three private couriers are known for their reliable and high-quality express services in the high-end market with shipping prices that are usually high. In the past few years, they have made efforts to adapt to e-commerce. DHL, for instance, created a new brand in 2014, DHL e-commerce, which is dedicated to innovating e-commerce logistics to address the growing demand in the global e-commerce market.

### *Logistic tech startups*

With the development of internet technology, digitalization has become an irreversible trend in modern services in the world. The Internet and AI technology are applied in all kinds of industries, finance, healthcare, and education, and transportation is no exception. At the same time, the rapid advance of urbanization has resulted in a shortage of resources in the city, leading to heavy traffic, a rise in labor costs, and social instability. Particularly in view of the boom in e-commerce, the demand for efficient logistics solutions has been rising dramatically. Traditional delivery services are no longer fulfilling the needs of consumers.

In such a context, many regional logistics tech startups have been springing up in an attempt to address the need by way of technology and innovative business models. The typical business model of these startups connects freelancers (“*motoboy*s”) with consumers in the marketplace. Although their market share is still small in the Brazilian e-commerce market and they are still not operating in the cross-border e-commerce market, it is anticipated that their presence will increase and expand rapidly.

BR Express assumed that logistics services for Sino-Brazilian e-commerce are polarized and that there are opportunities in between for an affordable, high-quality express delivery service.