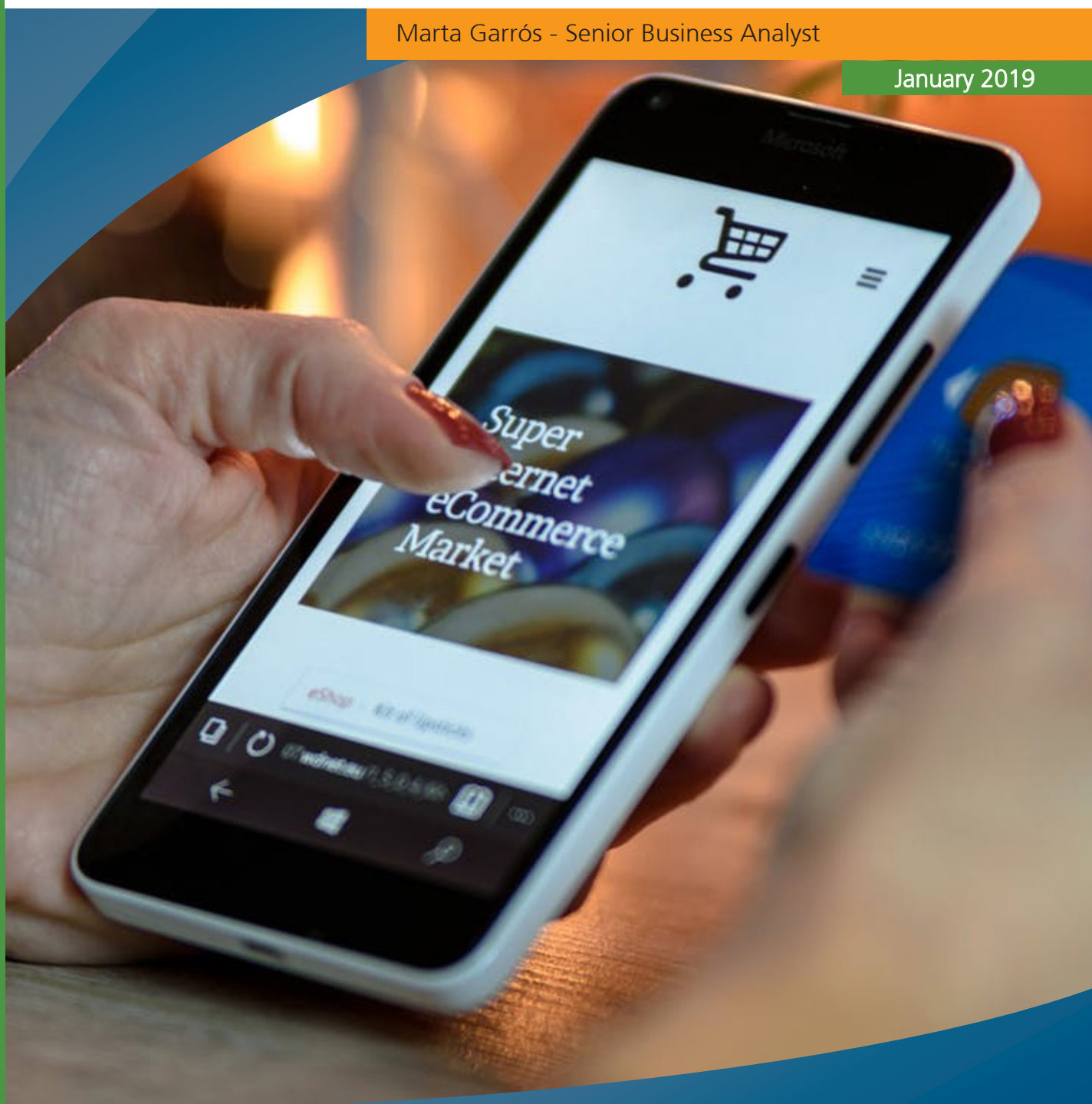


A diamond in the desert

Saudi Arabia's e-commerce market is poised to boom

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A diamond in the desert: Saudi Arabia's e-commerce market is poised to boom

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Digital Transformation is upending industries globally and the retail sector, once resistance to waves of disruption, is now under immense pressure following the rise of e-commerce.

However, the Gulf Cooperation Countries region, particularly Saudi Arabia, are playing catch up with the rest of the world and some

companies recognize the need to stay ahead of the curve and preempt the digital revolution.

Digital is changing marketplaces worldwide with new business models emerging. Retail companies don't own point of sales, big logistics providers don't own vehicles and the largest content providers don't own internet infrastructure.

Retailers are already suffering from customers migrating from offline to online and the e-commerce boom in countries like the US has already flattened malls profitability as e-commerce penetration reached 11.4% last year. Saudi Arabia's penetration in 2017 was 1.4%, which is less than half the US' in 2005.

Saudi Arabia has a high e-commerce readiness index that's not reflected in e-commerce growth. Aside from regulations that are not particularly favorable for online businesses, the Saudi population is skeptical of online shopping due to previously poor buying experience, concerns about the online payment process and delivery deficiencies.

Saudi Arabia has low credit card penetration, and debit cards have faced regulatory hurdles, so cash on delivery is the most used payment method (67% of payments are with cash). This leads to complex regulatory processes where merchants are subjected to a costly and complex process through national banks to set up e-payments, which lowers customer satisfaction.

With a private consumption of around \$270 billion, Saudi Arabia is the Middle East's largest market, with a competitive landscape that comprises a mix of traditional bricks and mortar and digital players, with Souq/Amazon and Noon controlling the lion share of the market.

Online expansion will be critical to meet shoppers' evolving demands and to remain relevant in a changing market environment. Bricks and mortar players are unable to meet new shopper demands, especially in Saudi Arabia, where 65% of the population lives in one of the three main cities, Riyadh, Jeddah or Eastern Region. This leads to lengthy travel to malls which are often overcrowded and difficult to shop with children.

Exhibit 1: 2017 e-Commerce penetration growth vs. readiness

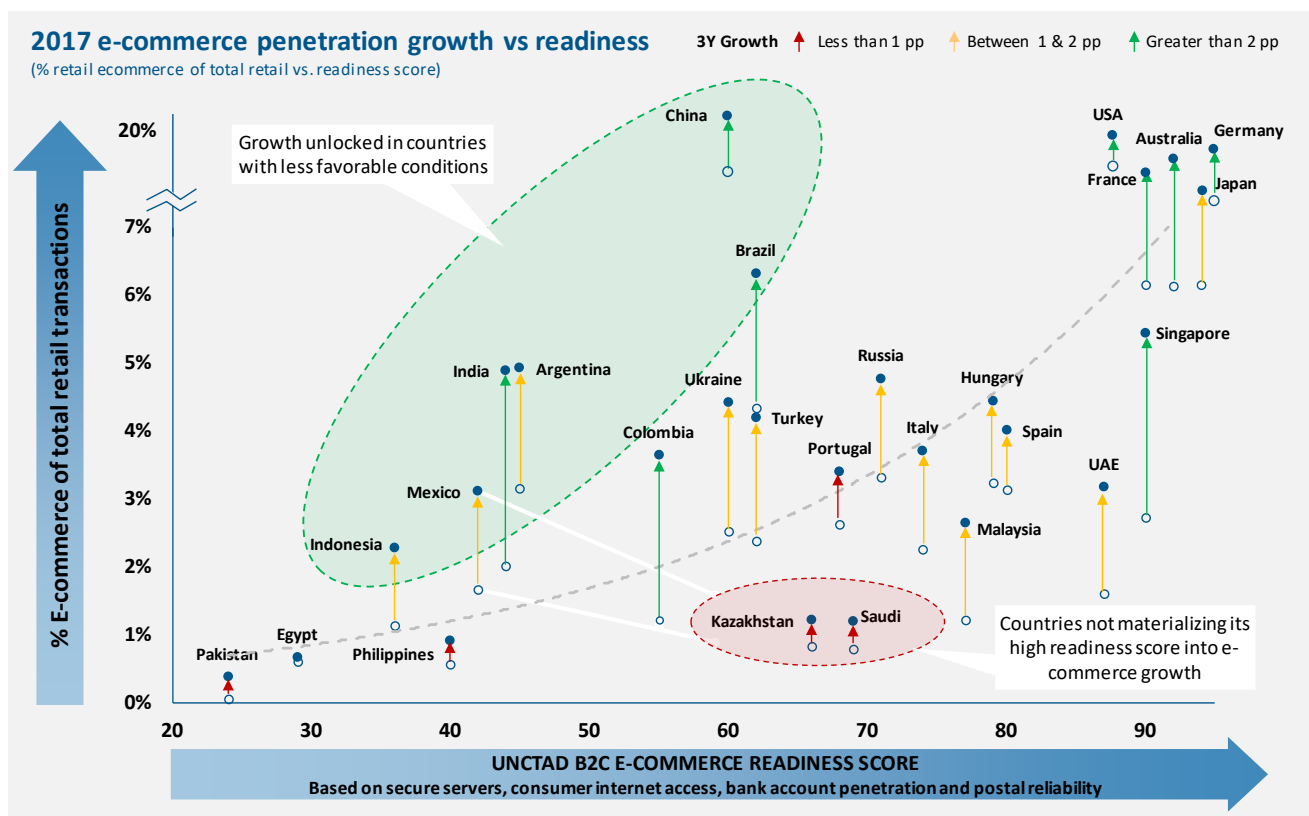
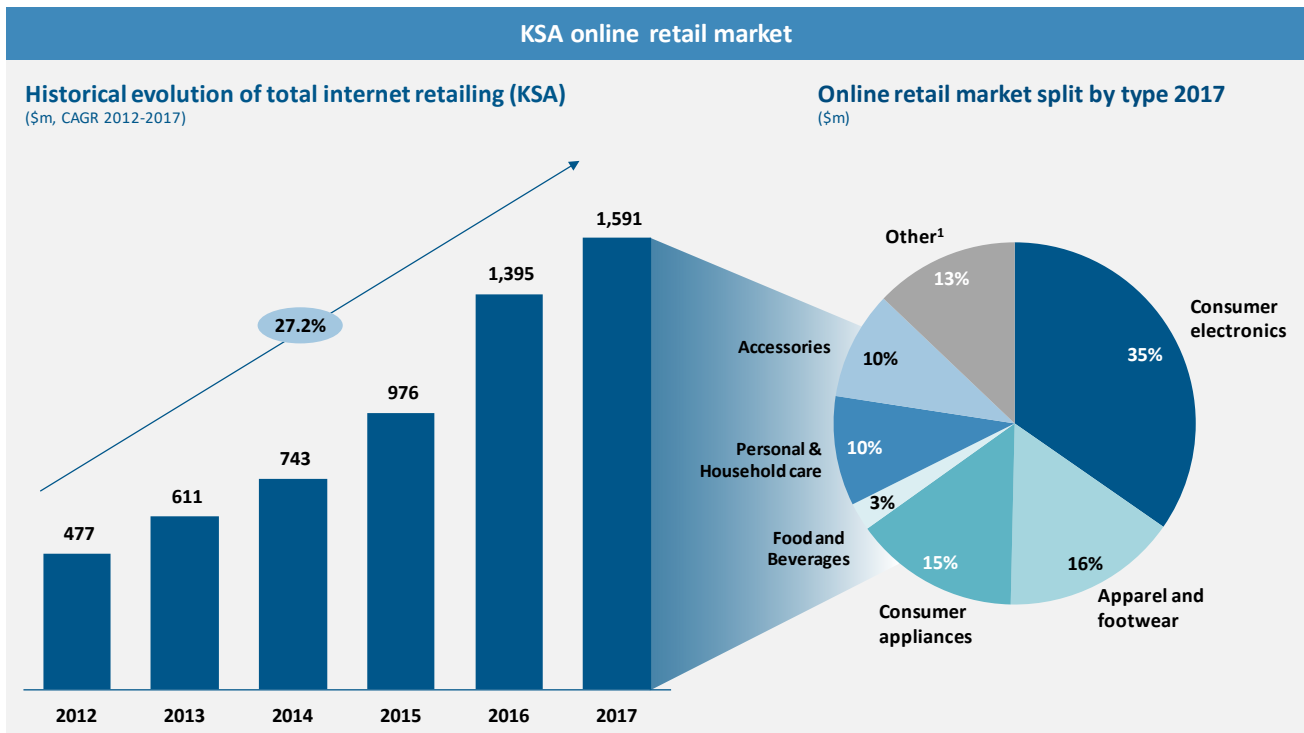


Exhibit 2: Online retail market in KSA



Note : ¹ Includes Clothing materials, Articles of clothing and clothing accessories, Furniture and Furnishings, Household textiles, Hardware and DIY goods and Newspapers, magazines, books and stationary;
Source: Delta Partners analysis

How is the ecommerce market in Saudi Arabia?

The Saudi online retail market is estimated to have reached \$1.6 billion last year driven by consumer electronics, apparel and footwear and consumer appliances, which represent 64% of the online retail market.

Saudi Arabian consumers have a strong tendency to purchase consumer electronics online, while food and beverages expenditure is almost entirely offline. Food and drink are the biggest expenditure (\$65.8 billion) but account for just 3% of ecommerce sales. Conversely, consumer electronics are the smallest expenditure but account for a fifth of ecommerce penetration.

Such figures position the Saudis as a conservative, risk-averse online shopper who only buy predefined items online.

The typical Saudi online shopper is mostly a local female, living in Riyadh or Jeddah and pays for the online purchases with cash on delivery.

Around 74% of online shoppers are 18 to 34 years old and mostly purchase electronics and household

goods. The low credit card penetration means to 66% of transactions are made using cash on delivery. There is still reticence in credit card adoption from the Saudi population, creating a barrier for ecommerce penetration. Also, cash on delivery as the preferred payment method in the country makes it harder for online players to manage treasury.

Despite having high digital saviness, Saudi Arabia online retail market is still embryonic. With a private consumption per capita of \$8,329 and the second largest mobile broadband and smartphone penetration globally, Saudi Arabia has only 1.4% of online retail penetration. Smartphones tend to be used for social media, where the average Saudi spends seven hours a day.

Saudi Arabia has a high ecommerce readiness index, but that's not reflected in ecommerce growth, which expands at similar pace to Kazakhstan. The main factors for that can be attributable to the following:

- **Legal and governance** - laws and regulations around ecommerce need to be updated for a digital economy, implemented and communicated to facilitate business;

Exhibit 3: Expenditure in KSA

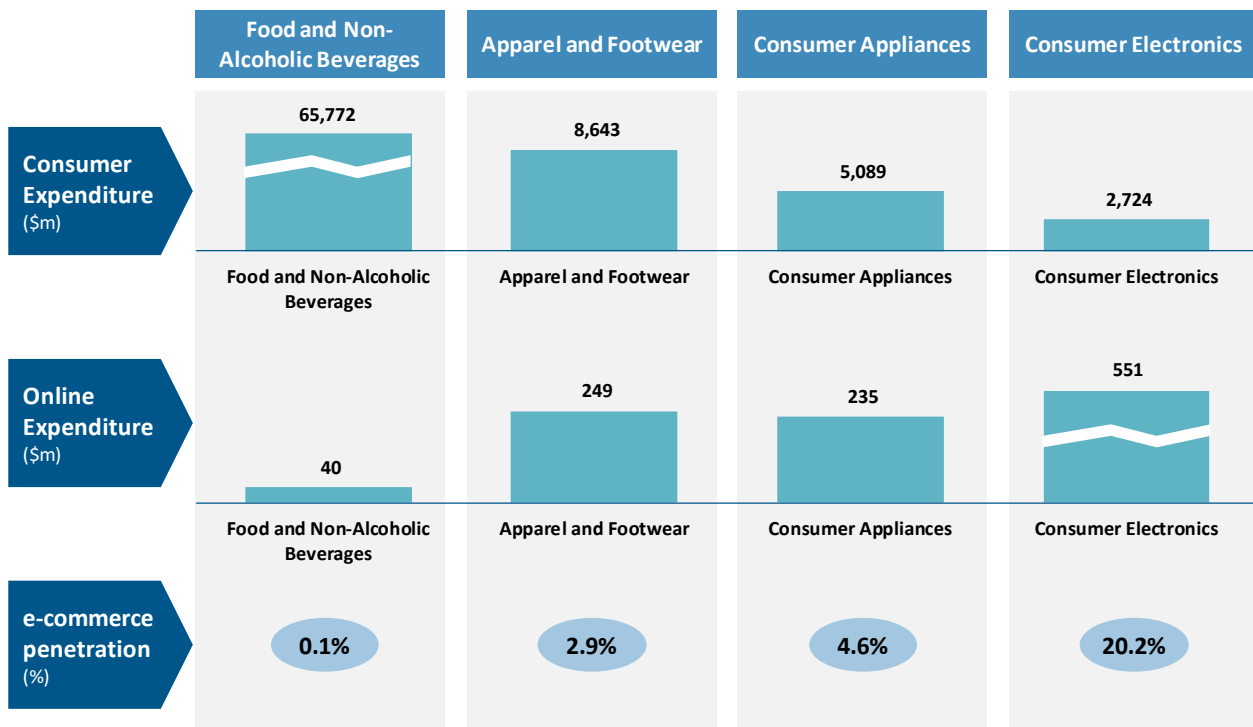
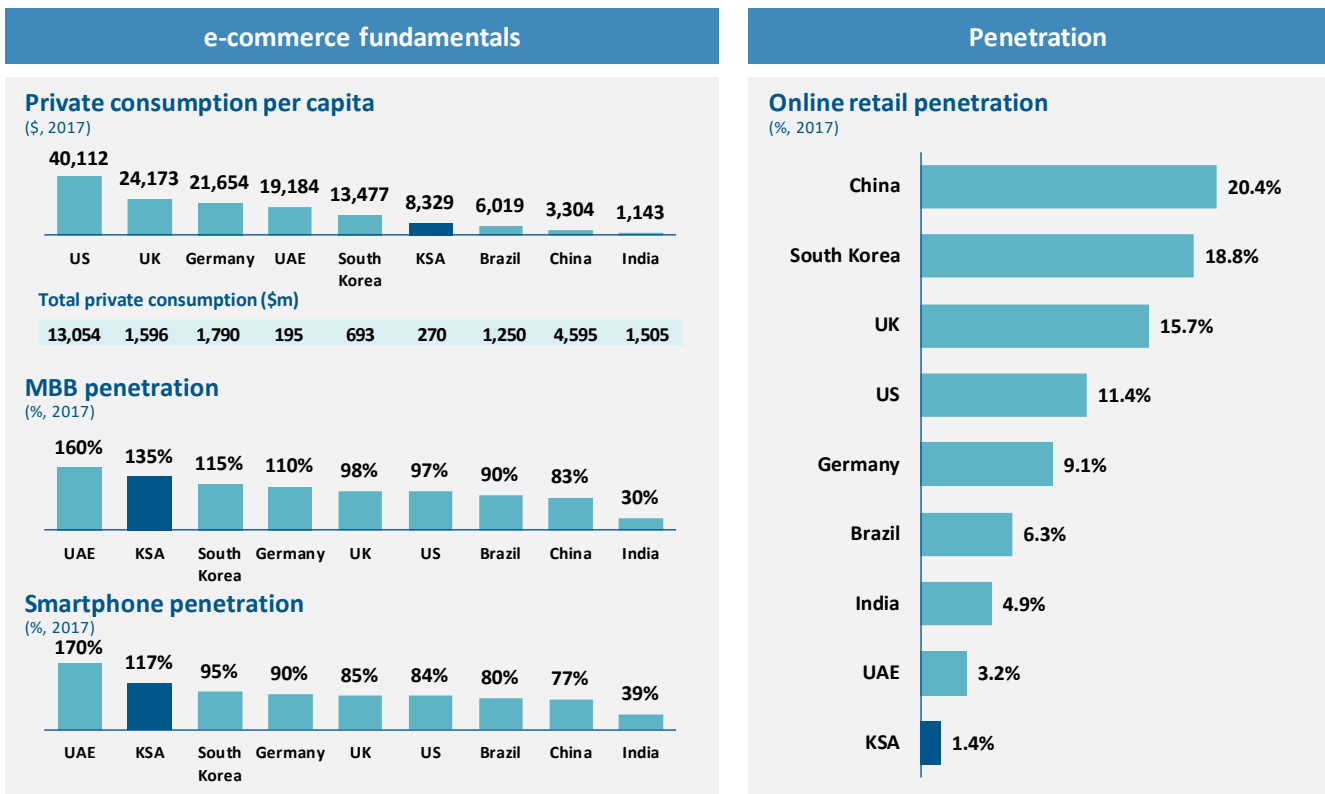


Exhibit 4: 2017 e-commerce fundamentals and online retail penetration in KSA



- **Customers** - lack of trust, security and awareness paired with a poor shopping experience and no consumer protection laws;
- **Payments** - complex regulatory process mean merchants are subjected to a costly process through national banks to set up e-payments. Customers are unsatisfied with existing payment methods (67% of payments are in cash in Saudi Arabia);
- **Logistics** - poor pricing and delivery performance that lacks coverage;
- **Merchants** - limited online presence of local sellers and merchants as well as limited export or regional trade for local merchants. Competition from international merchants has limited Government support;
- **Cross-border** - ambiguity about taxation and import duties as well as customs delays add to the lack of Saudi's market size to seize the benefits of ecommerce; and
- **Fragmented ecosystem** - only recent support for entrepreneurship and start-ups to grow, with complex company registration process, taxation, incubator support and funding issues.

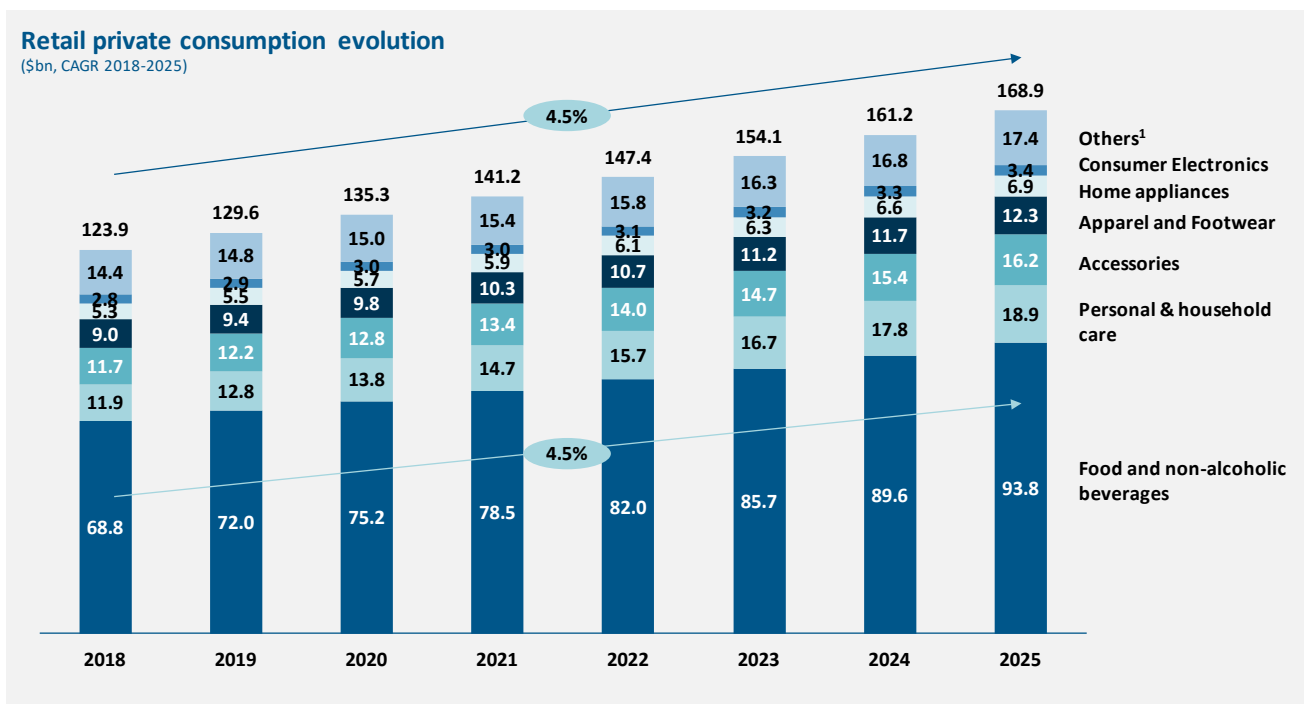
However, Saudi Arabia has the right mix of ingredients to ensure online retail market success and future growth, such as the size of the market that can drive volumes and economies of scale and efficiencies. With private consumption of around \$270 billion, Saudi Arabia is the Middle East's largest market and the right policies and support to facilitate e-commerce. An ecommerce law is being drafted with the objective of promoting trustworthy environment for online transactions and debit cards have started to be introduced in the country.

How is the market expected to evolve?

Saudi Arabia retail spend will continue to be strong, with a private spend on retail expected to grow at 4.5% CAGR, increasing from \$124 billion in 2018 to around \$170 billion in 2025. Food and beverages will be the largest vertical reaching \$94 billion in 2025, followed by personal care and accessories at around \$20 billion.

Growing competition, good access to know-how and improving access to funding are some of the key factors driving Saudi Arabia online penetration growth.

Exhibit 5: Retail private consumption evolution



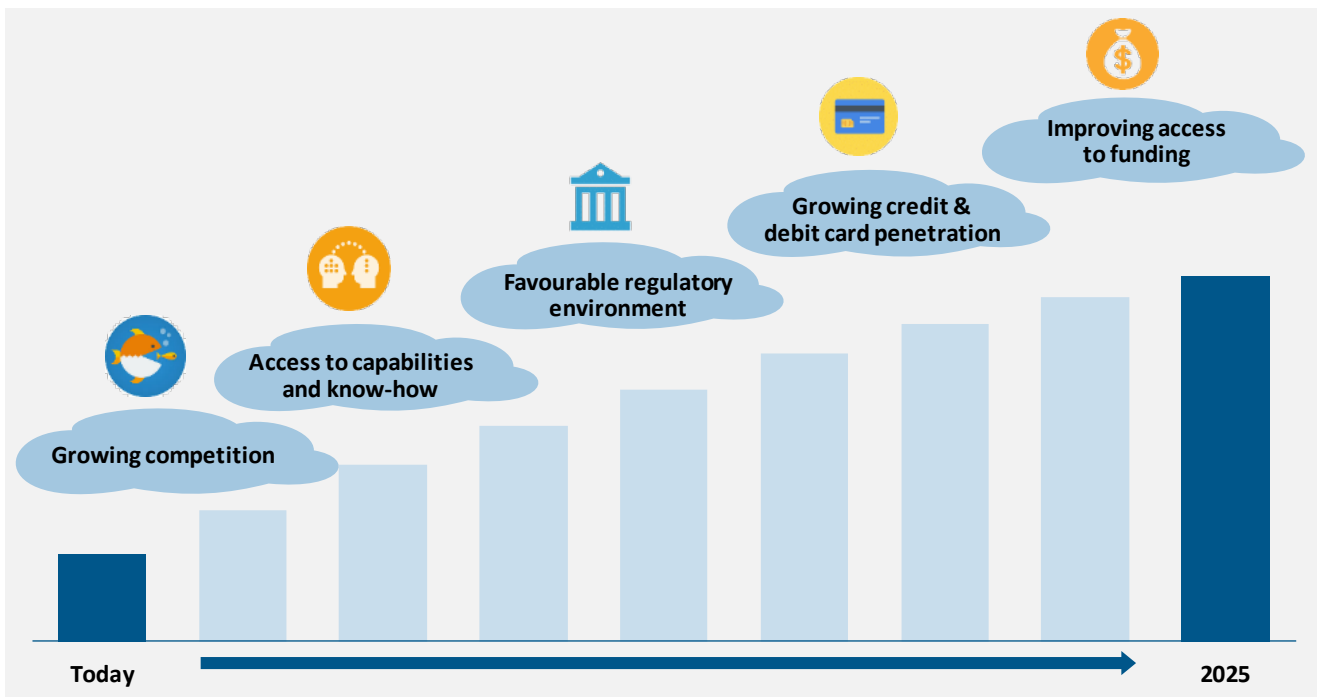
Notes: Non-retail products such as telecommunications services, transport services and other service related categories: ¹ Includes Clothing materials, Articles of clothing and clothing accessories, Household textiles, Hardware and DIY goods, Goods and services for routine household maintenance, Pharmaceutical products, Recreational items and equipment, Gardens and pets, and Newspapers, magazines, books and stationary; Source: Delta Partners a nalysis

Saudi Arabia “blended” online retail penetration is expected to reach the UAE’s current online penetration of 3.2% between 2020 and 2021 and a blended penetration of 5.3% by 2025. Consumer electronics will remain the most developed vertical with online retail penetration reaching 33%, followed by fashion and consumer appliances with 12% online retail

penetration in 2025, while online spend on food and beverages is set to reach 1.3% in line, which is in-line with US penetration today.

Saudi Arabia’s online retail market is expected to grow at 24.5% CAGR to \$9 billion in 2025, driven by apparel and footwear, personal care and accessories.

Exhibit 6: Key drivers online retail growth



The composition of the online retail market is expected to evolve from today’s consumer electronics centric market towards a more balanced market with fashion, accessories, personal care, consumer electronics and food and beverages contributing around 11%-16% each. Personal care, fashion and accessories online retail markets are expected to reach \$1.5 billion while the food and beverages online retail market is projected to reach \$1.2 billion, growing at a CAGR of 56%.

What’s the potential in the online groceries space?

Online grocery penetration tends to trail behind the average online retail penetration. The gap is the

smallest in highly digitalized economies, such as South Korea and Japan, where the online grocery penetration is on par with the market average.

In Europe, traditional bricks and mortar online grocery players have managed to build successful and competitive online grocery business. In the UK, Tesco online has a 40% market share and the traditional players jointly control two-thirds of the online grocery market.

The success of the traditional grocery players can be attributed to early market entry to pre-empt the online growth and the right choice of entry strategy.

Assortment, quality assurance, pricing and delivery are the key pillars of online grocery strategy. A typical online grocery platform has between 20,000-50,000

Exhibit 7: Share of online retailers around the world

United States					United Kingdom					China				
Online retail market (Top performers)					Online retail market (Top performers)					Online retail market (Top performers)				
Share	Company	Type	Sector		Share	Company	Type	Sector		Share	Company	Type	Sector	
33.0%	amazon	Digital	General		26.5%	amazon	Digital	General		43.1%	阿里巴巴集团	Digital	General	
7.8%	Walmart*	Retailer	General		10.1%	ebay	Digital	General		21.3%	京东商城	Digital	General	
7.4%	ebay	Digital	General		6.6%	TESCO	Retailer	Grocery		2.2%	苏宁易购	Retailer	Electronics	
4.7%	Apple	Retailer	Electronics		4.1%	Sainsbury's	Retailer	Grocery		2.9%	苏宁苏宁	Retailer	General	
1.8%	VALVE	Digital	Gaming		3.5%	John Lewis	Retailer	Dep. store		2.8%	唯品会	Digital	General	
1.6%	macys	Retailer	Dep. store		3.4%	SHOP DIRECT	Digital	General		1.2%	amazon	Digital	General	
1.4%	Home Depot	Retailer	Home		3.2%	max	Retailer	Fashion		0.8%	小米	Retailer	Electronics	
1.4%	LIBERTY INTERACTIVE	Invest.	Various		3.2%	Diions: Copphone	Retailer	Electronics		0.7%	Apple	Retailer	Electronics	
1.3%	STARS HOLDINGS	Retailer	General		3.0%	Apple	Retailer	Electronics		0.6%	当当网	Digital	General	
1.2%	Target	Retailer	General		2.5%	Sainsbury's	Retailer	Grocery		0.3%	聚美优品	Digital	Beauty	
1.2%	KOHL'S	Retailer	Dep. store		2.2%	ocado	Digital	Grocery		0.1%	Auchan	Retailer	Grocery	
1.2%	wayfair	Digital	Home		1.9%	Walmart*	Retailer	General		0.1%	苏宁易购	Retail	n.a.	
1.1%	Costco	Retailer	General		1.4%	MARKS & SPENCER	Retail	General		0.1%	SMG	n.a.	n.a.	
1.1%	WSJ	Retailer	Home		1.2%	OSOS	Digital	Fashion		0.1%	DELL	Retailer	Electronics	
0.8%	NORDSTROM	Retailer	Dep. store		1.1%	ad.com	Digital	Electronics		0.1%	n.a.	n.a.	n.a.	

Source: Delta Partners analysis

Stock Keeping Units and perishables are a common component of the online assortment for mature players. Many players launch with significantly smaller portfolio of products often excluding perishables from the assortment. Fresh produce quality assurance is managed through frequent training, technology and feedback.

Online pricing strategies mimic offline pricing, including bulk discounts to increase spend and thematic promotions (i.e. Easter theme). The online grocery players offer wide array of delivery options including in-store pick up, "drive and collect" and many variations of home delivery (express, slotted and flexible).

Except for South Korea, the online grocery penetration remains relatively low and online groceries generally trail behind the overall online retail market.

Online grocery spend is forecast to beat offline spend by a significant margin, largely attributable to the different shopping frequency patterns between the two channels.

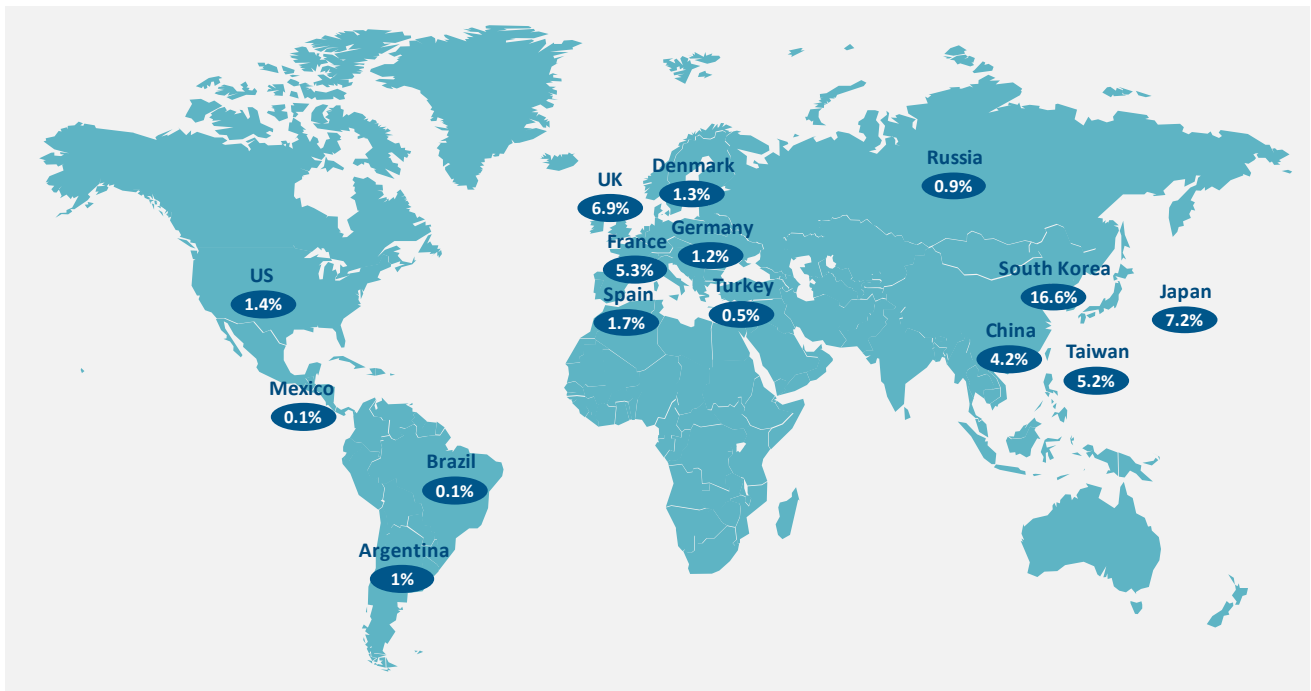
In Asia and the US, the online grocery market tends to be dominated by online-only players, while in Europe digitalized bricks and mortar retailers lead the way.

South Korea is a highly digitalized economy, with a habit of shopping from home established by adoption of TV shopping in 1995) and high population concentration. China is another highly digitalized economy with online grocery space dominated by vertical extension of leading generalist players such as Alibaba and JD.com.

India has a heavily funded pure play online grocery leader, BigBasket, followed by vertical expansion of leading market generalists like Flipkart and Amazon.

Western countries have a different type and pace of online groceries adoption. The US, usually a pioneer for consumer habits and technology adoption, has a relatively nascent online grocery market. It's dominated by Amazon, but Walmart has a relevant online presence. Conversely, the UK has a highly challenging online groceries market, as all brick and mortar players have online channel, making it harder for new entrants to tap this market.

Exhibit 8: 2016 Global online grocery penetration



Source: Kantar retail

France is different, with a high popularity of click-and-drive (shop online and collect in store) model responsible for online groceries adoption.

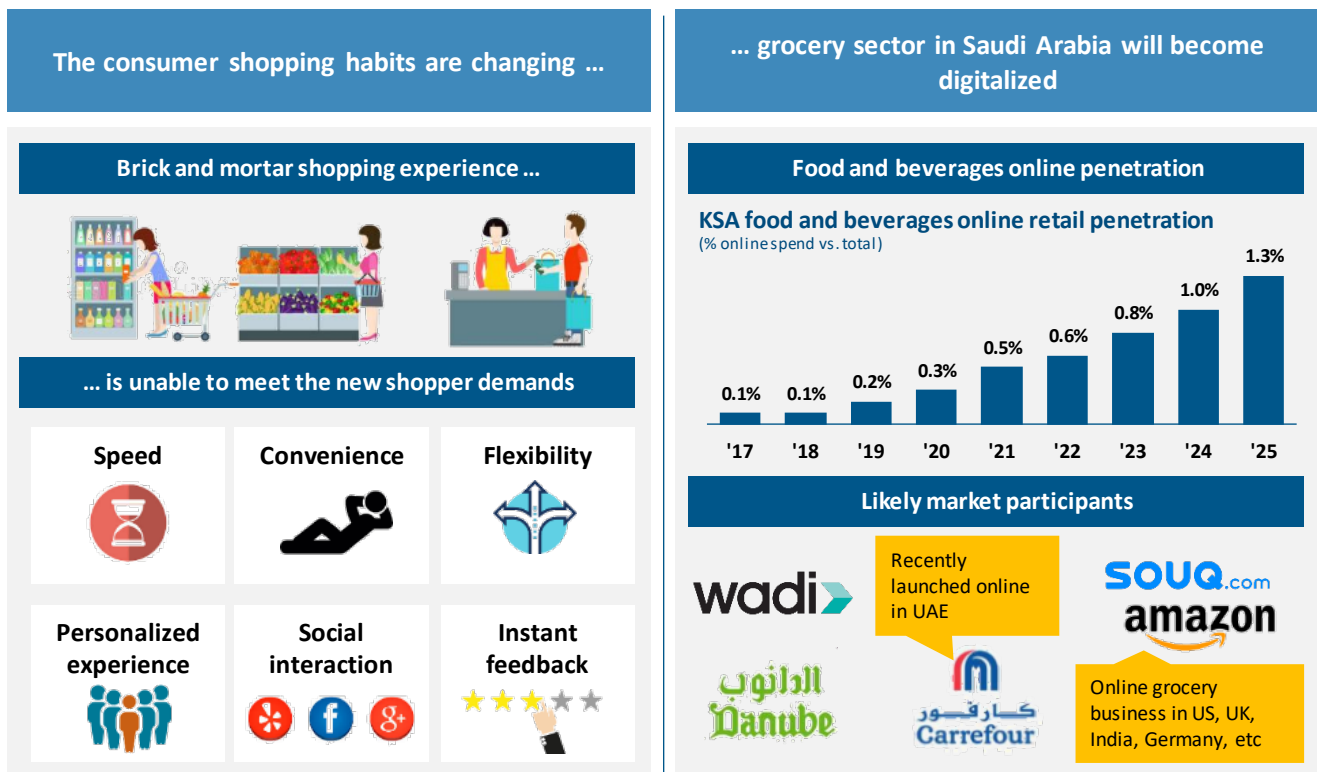
Last year, Saudi consumers spent round \$36 million on food and beverages online, which is around 0.1% of the online market and significantly below the country's average online retail penetration of 1.4%. The low online grocery penetration can be attributable to an almost non-existent online grocery ecosystem with a handful of small players lacking sufficient funding to scale the business.

The current market conditions are ideal for the entry of an online grocery player to disrupt and develop the market, which is currently highly fragmented.

Limited online development by the leading retail players paired with high offline market share concentration within the fragmented convenience stores ecosystem offer the perfect conditions for market disruption, offering attractive growth opportunities. Recent competitive movements in the space, such as Majid Al Futtaim investment in Wadi groceries, confirm the attractiveness of the opportunity.

The Saudi Arabian online food and beverages market is projected to reach around \$1.1 billion in 2025 driven mainly by favorable demographics conditions, development of the overall retail market, a tangible improvement in logistics and competition.

Exhibit 9: Consumer shopping habits and food and beverages online penetration in KSA



Conclusions

The grocery sector is not immune to the changes that the digital revolution is bringing to shopping habits and the traditional shopping experience will fail to meet shoppers' evolving demands.

Organic developments, partnerships, minority investments and acquisitions are most commonly used online expansion strategy.

Based on a global benchmark of leading offline-to-online grocery players, organic development was the strategy of choice during the early wave of online grocery expansion, like in the UK at the turn of the millennium. In today's market environment, partnerships are emerging as the preferred strategy with several leading grocery chains uniting with e-commerce players.

Online expansion is critical to meet the shoppers' evolving demands and to remain relevant in a changing environment.

Saudi Arabia has the right blend of components to join the ecommerce game. The country is striving to add a new chapter to its history by positioning itself as a leisure destination, developing an entertainment industry and opening the country towards a direction that was unthinkable until recently.

The willingness from the new crown promises to encourage the right conditions for a new political and economic climate to thrive. Saudi Arabia's currently underdeveloped e-commerce market is an opportunity to enjoy the growth that's likely to follow a country reshaping its trajectory from a conservative model towards a digital nation with assets and industries.

Marta is a Senior Business Analyst that works in the Delta Partners' Dubai office. She has experience in multiple strategy definition and execution projects across the Middle East and South-East Asia region, working with large operators and digital players.

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