

Getting in on the GCC E-Commerce Game

With much of the groundwork in place, the region is on the edge of becoming the world's fastest growing e-commerce playground. Traditional retailers that shake their inertia can capture substantial benefits.

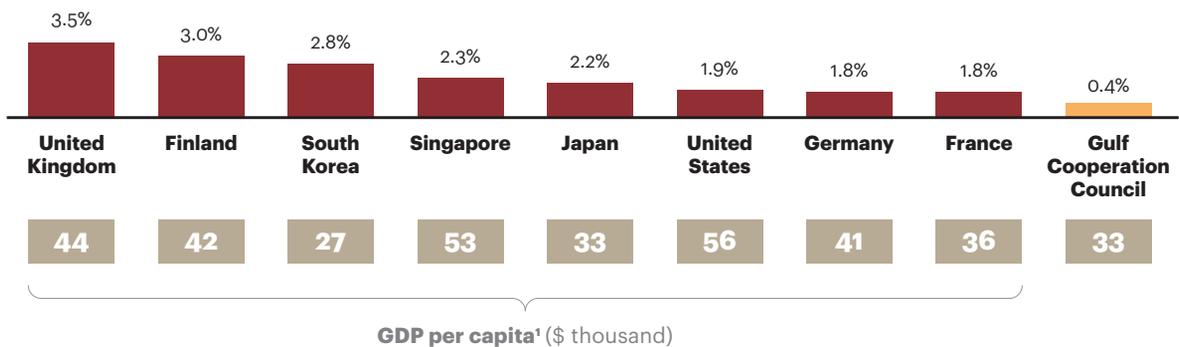


A Challenging Proposition

Despite strong fundamentals, the Gulf Cooperation Council (GCC) is one of the world’s most challenging e-commerce playgrounds. With some of the world’s highest levels of GDP per capita, the region is home to many people with large disposable incomes. Average mobile penetration stands at more than 170 percent, and smartphone penetration is at more than 65 percent. In addition, more than two-thirds of the population uses the Internet, with penetration in the United Arab Emirates (UAE) and Qatar exceeding 90 percent (including fixed and mobile). And yet, the e-commerce market is very small. With an estimated market size of \$5.3 billion in 2015, e-commerce contributes only about 0.4 percent to the region’s GDP—a miniscule amount compared with more mature markets that have similar levels of GDP per capita and Internet penetration (see figure 1).

Figure 1
E-commerce contributes relatively little to the region’s GDP

E-commerce as % of GDP¹
 (2015)



¹ Nominal value considered
 Sources: eMarketer, World Bank; A.T. Kearney analysis

Several obstacles are preventing this market from reaching its full potential, including consumer trust and awareness issues; shortcomings in the payments, distribution, and logistics infrastructure; and embryonic government policies. For example, consumers continue to make a disproportionate number of payments in cash: 67 percent of all payments in Saudi Arabia and 58 percent in the UAE are cash-based. The primary factors influencing this high use of cash are limited alternatives to cash and consumers’ low satisfaction with existing payment methods. Primary market research commissioned by A.T. Kearney reveals that more than half of all Saudi Arabian consumers were dissatisfied with current options, such as payment cards, mobile apps, and point-of-sale terminals. Interestingly, more than half also expressed dissatisfaction with cash as a payment method, yet cash continues to dominate.

Additional concerns about data security and fraud compound customer trust issues. According to a recent Norton study, 40 percent of mobile shoppers in the Middle East and North Africa

have been victims of cybercrime, and 71 percent say they observed cyber attacks in the region. At the same time, awareness of e-commerce is low with only about half of the Internet users in the UAE even aware of e-commerce platforms. The limited offering, in terms of both breadth and depth, along with local retailers' weak incentives and promotional efforts have resulted in this lack of awareness. Meanwhile, savvy customers prefer international online platforms, which offer more choices and easier shopping.

On the payments infrastructure front, the region is still evolving and has relatively low penetration for banking and payment cards. In Saudi Arabia, for example, about half of the population is unbanked, and payment card penetration is only about 40 percent—much lower than the developed world's banking and cards penetration of more than 80 percent. In terms of distribution, most retailers have inadequate warehouse coverage across the region for the rapid delivery of products (less than 24 hours) that more customers are demanding. Based on our analysis, fewer than half of the top GCC retailers offering e-commerce have a regional distribution center, which results in more imports and higher airfreight costs. The region's lack of postal codes augments this problem, throwing last-mile logistics companies into a sea of confusion when delivering products. In addition, the lack of scale in parcel delivery and the limited number of couriers have resulted in high costs for last-mile delivery.

Despite large disposable incomes and strong telecom penetration, **e-commerce contributes just 0.4 percent to GCC GDP.**

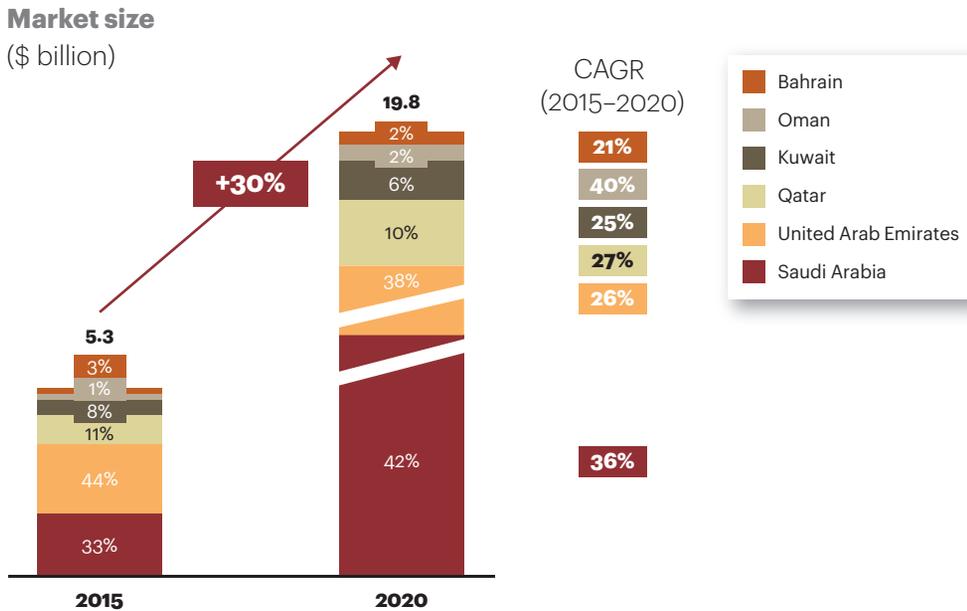
Finally, government policies about e-commerce are still evolving, leading to an inefficient cross-border marketplace for retailers. Our interviews with the region's leading e-commerce companies attest to this. Ambiguity about taxation and import duties is often cited as a reason for customs delays and suboptimal costs of cross-border trade. Limited protection during disputes about delivery and product quality is another issue affecting both retailers and customers.

Seizing the Growth Opportunity

Our study reveals that only 34 percent of major GCC retailers have an e-commerce channel, compared with about 58 percent in the United States. However, with the right enablers in place, we believe the GCC e-commerce market could almost quadruple to reach \$20 billion by 2020 (see figure 2 on page 3). With 30 percent CAGR, e-commerce is expected to outpace traditional retail's 9 percent CAGR in this same period. Several factors will drive this growth, including greater awareness of e-commerce, higher online conversions, and more retailers offering e-commerce solutions.

Quick to spot this potential, pure online players (e-tailers) such as Souq.com have invested heavily in developing capabilities and overcoming local challenges. More funding for e-tailers also underscores investors' confidence in the potential of e-commerce. In recent years, Souq.com has received more than \$275 million to support its rapidly growing business, including a payment platform. Fashion e-commerce retailer Namshi raised at least \$35 million,

Figure 2
GCC e-commerce market could see rapid growth



Note: Market size excludes travel and tourism, event tickets, subscriptions such as Netflix, business to business, wholesale, and industrial transactions.
Source: A.T. Kearney analysis

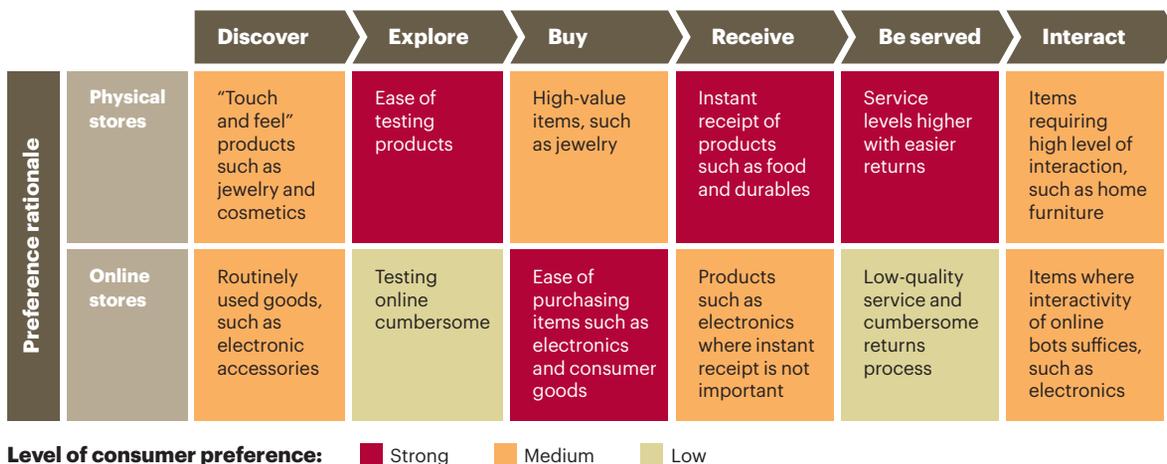
and the online shopping community MarkaVIP raised at least \$20 million—funds that both companies are using to bolster their logistics operations, among other things. As brick-and-mortar retailers take a back seat, much of the e-commerce growth is expected to come at the expense of traditional retail.

Despite their slow response thus far, traditional retailers can be on the winning side of e-commerce in the next five years. An omnichannel approach will be essential. An A.T. Kearney study of US consumers’ behavior across the various stages of the customer journey reveals that 55 percent use both physical and online stores, highlighting that the future is not digital only but physical with digital—something traditional retailers can use to their advantage (see figure 3 on page 4).

However, the push toward omnichannel is not limited to traditional retailers. Several e-tailers have recently ventured into setting up physical stores. Amazon, the e-commerce market leader, launched a brick-and-mortar store in Seattle in 2015 with plans to open a second one in California. Warby Parker, an online retailer of prescription eyeglasses and sunglasses, opened eight stores in 2013 and 2014 to serve as product showrooms and click-and-collect points, where customers can buy online and then pick up in a store. Average sales per square foot have been equivalent to Tiffany's and almost two and a half times Best Buy's.

For GCC retailers, the success of omnichannel strategies will depend mainly on their ability to develop a strong online presence, provide robust payment mechanisms, and invest in distribution and infrastructure. In addition, they will need to collaborate with regional governments to resolve the bottlenecks in policies that will remain crucial to the ongoing success of a cross-border e-commerce ecosystem.

Figure 3
The future of retail is both physical and digital



Source: A.T. Kearney analysis

Building a Strong Online Presence

E-commerce success goes well beyond setting up an online portal. A solid foundation includes several essential elements.

First, consumers are more likely to embrace omnichannel with a **seamless customer experience** across all physical and online channels. Overall consistency from the physical store to the online channel and customer engagement are vital to attracting and retaining customers. Traditional retailers have a distinct advantage over e-tailers in this area with their brick-and-mortar shops. In mature markets, retailers have capitalized on this advantage using varying approaches to achieve the desired customer experience (see figure 4 on page 5). Macy's, for example, has in-store Beauty Spot kiosks that integrate the convenience of online shopping with the immediacy of being in the store ready to buy cosmetics, making the overall shopping experience easy, interactive, and more effective. In addition, Macy's iShop mobile app helps shoppers find what they want as they navigate physical aisles and departments. Promotions on Facebook, Foursquare, Pinterest, Twitter, and other social channels get customers engaged, thinking, and talking about Macy's even when they are not in a store.

Investments in technology also support a strong online experience. Consider the potential in e-tail websites and mobile apps that look and function like actual stores or more novel concepts such as virtual fashion mirrors that let customers "try on" an outfit, capture an image, and share it online with friends via social networks. Online channels offer exciting ways to promote little-known or new products, enhance customer service, and engage shoppers in exciting new ways.

UK-based retailer John Lewis invested more than \$200 million in new shops, store refurbishment, and IT and distribution infrastructure to support a seamless omnichannel experience for its customers. Most of its stores now offer click-and-collect, virtual fashion mirrors, and in-store QR and bar-code scanners that shoppers can use to get information about product features, availability, and delivery.

Figure 4
Many traditional retailers have gone omnichannel

	Discover	Explore		Buy	Receive	Be served	Interact
		Long list	Short list				
Apple	<ul style="list-style-type: none"> Strong store network plus online store Consistent store-in-store concept across all retailers 			<ul style="list-style-type: none"> Universal identity across channels 			
John Lewis				<ul style="list-style-type: none"> Focus on online channel growth in addition to traditional department stores Channel agnostic fulfillment options 			
Conrad	<ul style="list-style-type: none"> Full brand position designed around Germany's "cross-channel champion" 						
Nike	<ul style="list-style-type: none"> Effective use of social media as a multiplier 						<ul style="list-style-type: none"> Nike identity and Nike community
Burberry	<ul style="list-style-type: none"> Outstanding in-store experience Integration of online channel into traditional, exclusive offline events such as fashion shows 						
Macy's	<ul style="list-style-type: none"> Large investment in in-store technology 				<ul style="list-style-type: none"> High fulfillment certainty with leverage from 500 stores 		<ul style="list-style-type: none"> Interaction through apps and social media

Source: A.T. Kearney analysis

Technology mega-trends such as 3-D printing, the Internet of Things, and artificial intelligence will offer more possibilities for customizing the overall customer experience. In a rapidly changing world, retailers conversant about the latest technologies will be better positioned to disrupt the retail experience.

An **attractive and diverse product portfolio** will draw more customers online. To date, more than 90 percent of the GCC e-commerce market is in only four product categories: consumer electronics, fashion, lifestyle, and health and beauty. In contrast, these categories make up half of the US e-commerce market, with categories such as pet care, toys and games, food and drink, home improvement and gardening, and home furnishings making up the other half. Clearly, there is room for GCC online retail expansion. To entice more customers to shop online, retailers must offer a more diverse product selection, capitalizing on the long-tail advantage of e-commerce. In fact, online-only propositions and promotions can spike customer interest, drive traffic online, and increase online revenue.

In addition, consumers will only trust online channels if retailers focus on **protecting customer privacy and data**. By developing and promoting secure websites, retailers can alleviate

the public's fears. Customers need to know that personal information uploaded to a store's website will not be shared with third parties and will be kept secure. Recent developments in tokenization and Internet Protocol version 6, which comes with embedded security, should improve data security.

However, added security should not come at the cost of an attractive customer experience and ease of access. Consider Apple's tough security and privacy protocols. Every customer has an Apple ID associated with their information, which is stored on secure servers and is inaccessible by any third party. Stored in the cloud, the information is encrypted and requires a two-stage verification process. Even with all this security, Apple IDs work seamlessly across all channels.

Omnichannel retail is new territory for GCC retail employees. To have a strong online presence, retailers must not only understand the online component but also define every employee's role in it. **Training and development** will ensure that retailers' employees and partners are skilled in omnichannel best practices across core areas, including design, in-store customer service, and technical support. Macy's, for example, has a rigorous in-house training program called Magic Selling, which focuses on customer service and the customer experience. Sales associates are trained to make natural connections with shoppers, inspire them to make purchases by offering highly personalized options, and then celebrate purchases. Macy's has trained more than 130,000 associates using this program, which was instrumental in increasing the firm's profits by more than 20 percent between 2012 and 2015.

Provide Robust Payment Mechanisms

Online payments and wary shoppers are among the biggest factors limiting GCC e-commerce. The main obstacles include limited bank coverage, a large unbanked population, a challenging regulatory environment that promotes banks as the primary providers of payment services, and the low technological enablement of payment mechanisms, such as near-field communication and radio-frequency identification. As a result, at least 60 percent of online orders are paid in cash at the point of delivery. Cash on delivery is expensive for retailers because they must bear the risk upfront, which can negatively affect cash flow, in addition to the risks that come with carrying cash. Retailers need to partner with and invest in online payment platforms and gain customer acceptance of these options.

Retailers have a plethora of readily available online payment solutions—including PayPal, PayFort, and PayTabs—where they can form ecosystems to ensure interoperable payments. Developing and deploying these payment ecosystems can be achieved by forging partnerships with **best-of-breed providers** that are already active in this space, such as international payment players, regional banks, and telecoms. E-storefronts such as Shopify and ShopGo not only provide an integrated payment platform but also provide Web development support, including the technical services necessary for e-commerce. Retailers can also explore alternate payment solutions such as mobile money, collaborating with telecom players and taking advantage of the GCC's high mobile penetration. M-Pesa, a mobile money offering from Kenya's leading telecom operator Safaricom, has more than 15 million active subscribers with transfer of money greater than 15 percent of Kenya's annual GDP.

For several e-commerce players that were early movers and had to serve underdeveloped and under-served markets, developing their **own payment solutions** has also been a successful strategy. The best example of such a strategy is Alibaba's introduction of Alipay in China.

Launched in 2004, Alipay is now a third-party online payment provider, functioning largely as an escrow service where payments are released once customers are satisfied with their purchase. This solves cash-on-delivery issues while also helping customers overcome the fear of online transactions. Now affiliated with more than 65 financial institutions, including Visa and MasterCard, Alipay is compatible with mobile platforms and can function as a mobile wallet. With 290 million active users, it is the world's largest payment platform.

Within the GCC, Souq.com has created two successful payment platforms. CashU, which became an independent company in 2015, is a payment gateway that is incorporated into merchants' websites and offers online prepaid coupons for shoppers to use on participating retail websites. To mitigate customer security concerns, CashU systems use advanced anti-money laundering and fraud protection technology. PayFort, which Souq.com owns and developed as a spin-off from CashU, allows Souq.com and other merchants to accept secure, encrypted credit card payments. To facilitate online purchases, PayFort also offers the option to pay bills online in installments.

While developing payment systems has been a successful strategy for some retailers, we recommend a partnership approach because it results in easy access to know-how and technology and a quicker route to market. Partnerships also help overcome several regulatory barriers to payments that are present across the GCC.

With the right enablers in place, the GCC e-commerce market could almost **quadruple to \$20 billion by 2020.**

Invest in Distribution and Logistics

A suboptimal distribution and logistics infrastructure not only lengthens delivery times, but also reduces efficiency and raises handling costs. To mitigate these challenges, retailers will need to review their distribution strategy (make versus buy), including assessing the need to build new fulfillment and logistics facilities, capitalizing on technology, and forging strategic partnerships with logistic providers. Retailers can adopt one or more of these approaches based on their strategy.

In the United Kingdom, retailer Marks & Spencer made significant investments to strengthen its distribution and logistics capabilities to allow for 24-hour delivery. Its distribution facility in Central England can hold up to 16 million items, and through its **partnership with logistics provider** Blue Arrow, the retailer ensures rapid delivery to everyone in the United Kingdom.

Flipkart, a leading e-tailer in India, developed its own independent logistics arm, Ekart, and acquired WS Retail to handle last-mile logistics. Flipkart also has regional warehouses to reduce its dependence on air transport and partners with several companies to fill distribution gaps, including online freight-booking service MapmyIndia and QikPod.¹

¹ MapmyIndia offers navigation maps and driving directions in India via the Internet, GPS and in-dash devices for vehicles, and mobile maps. QikPod offers a growing network of pick-up lockers.

Within the GCC, several retailers are investing in **building their own distribution capabilities**. For example, in 2016, IKEA opened one of the Middle East's largest distribution centers in Dubai to serve all Middle East markets. Souq.com launched its logistics platform subsidiary, Q Express, which owns trucks and logistics vehicles, hires its own employees, and has complete control of end-to-end logistics for purchases made on Souq.com. Q Express offers same-day delivery in some areas and next-day delivery in others. Delivery vehicles are equipped with personal digital assistants for order tracking and status updates. Souq.com also owns warehouses across the United Arab Emirates, Saudi Arabia, and Kuwait where customers can pick up their purchases.

Another compelling example is the recent acquisition of Aramex, a leading logistics provider across the Middle East, by Boson Ventures. Reportedly, Boson Ventures, an investment vehicle backed by Emaar Properties PJSC Chairman Mohamed Alabbar, purchased a 10 percent stake in Aramex. The deal—estimated to be in excess of \$150 million—intends to capitalize on Aramex's proven logistics capabilities and growing e-commerce technology platform, laying a strong foundation for future e-commerce endeavors in the region.

Technology will be essential for tackling postal code issues. For example, Google Express uses Internet navigation to deliver perishables, such as food products, within two to three hours. The company does not maintain warehouses or inventory. Instead, it delivers groceries through partnerships with retailers. When a customer places an online or mobile order, Google Express turns to Google Maps to identify the customer's location and the nearest retail partner, which it directs to fill the order. GPS positioning, rather than postal codes, makes for an efficient process from ordering to delivery.

Traditional GCC retailers have an advantage in their physical proximity to customers. Models such as pay online and pick up in stores can shrink delivery times while also increasing store traffic.

Time to Take the Plunge

GCC e-commerce is on the cusp of becoming the world's fastest growing market. However, this growth could come at the expense of traditional retail. As consumers become more tech-savvy and embrace e-commerce, e-tailers will have the first-mover advantage. Traditional retailers that took a wait-and-see approach will need to act now to reserve a share of this fast-growing market. An omnichannel approach with a strong online presence, robust payment mechanisms, and an efficient distribution and logistics network will put retailers on course. The question remains: are traditional retailers willing to shake their inertia, take the plunge, and disrupt their established business models?

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