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The Middle East region has witnessed strong growth of e-commerce despite weak links in the value chain

On many counts, the past two years have been extraordinary for e-commerce in the Middle East. The total value of online transactions in the region grew three- or even four-fold in some countries. A number of regional start-ups bucked the e-commerce trend with many overpassing the symbolic USD 1m mark in revenues after less than two years of operations. Some of these success stories include JadoPado, EmiratesAvenue and Alshop. Simultaneously, group-buying companies such as Cobone also drove the growth of e-transactions in 2011 though the trend has receded in 2012 with the exit of Livingsocial from the market. One of the first homegrown movers in this space, Souq.com, has consolidated its leadership in the market through acquisitions (including Sukar.com, the online private shopping club) and grew its business from an “à-la-eBay” auction platform to a full-fledged fixed price online marketplace. E-commerce companies have also attracted a significant amount of foreign investment with Souq.com, Namshi and MarkaVIP securing USD 75m overall last year from foreign investors including the likes of JP Morgan and Naspers.

However, the spectacular growth of e-commerce hides some important gaps in the market and some missing links in the e-commerce system that need to be addressed in the next few years to allow for the sustainable growth of online business in the region.

Consumers’ adoption of e-commerce still immature

On the demand side, and despite the growth experienced over the past two years, e-commerce adoption remains relatively low compared to international benchmarks and varies greatly by country. In a recent survey conducted by Deloitte and Ipsos on

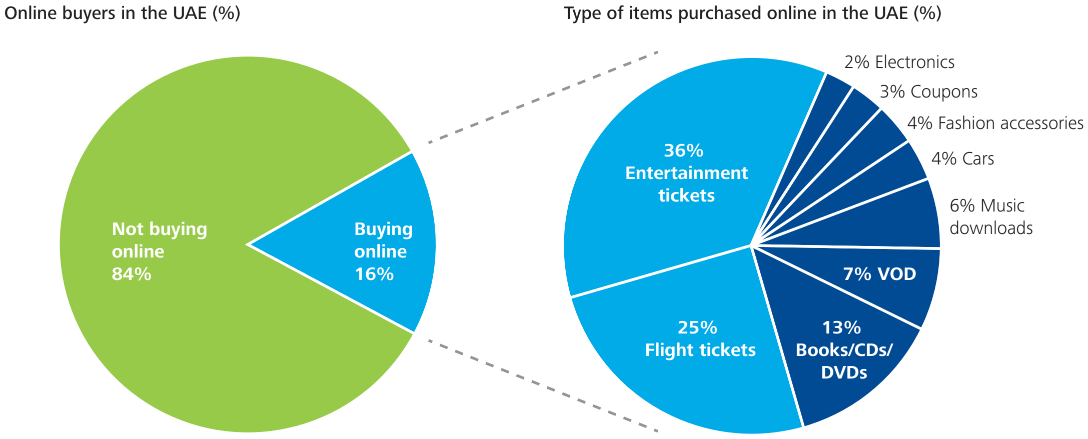
media and online behaviors in the Arab world, it averred that 16 percent of the population in the United Arab Emirates (UAE) shops online. In other markets such as Morocco, Egypt and Saudi Arabia, e-commerce penetration appeared to be significantly lower at 2-3 percent of the population. A second indicator reveals that e-commerce in the region remains in its early adoption phase as online shoppers in the Middle-East tend to buy limited physical goods such as electronics or fashion items and buy primarily tickets, usually perceived as less risky to be purchased online. Indeed, in the same survey, ticketing (including entertainment and flights) still makes up for more than 60 percent of online purchases.

Three core enablers are essential to ensure a vibrant e-commerce market: good logistics, fit-for-purpose regulation and effective payment gateways

Small and medium businesses in the region have yet to embrace the e-commerce trend

On the supply side, with a few regional exceptions, the market remains dominated by international heavyweights – Carrefour's online retailer for instance is believed to account for around 20 percent of total e-commerce transactions in the UAE. More importantly, while the region – and specifically Jordan and the UAE – has seen the advent of a number of e-commerce start-ups, the vast majority are online marketplaces such as MarkaVIP or Souq.com and there is limited adoption of e-commerce as an alternative retail channel amongst the Small and Medium Business (SMB) segment. The growth of e-commerce worldwide has been fueled by a number of high-profile success stories of small businesses online – from selling cupcakes to oversized shoes. In the Middle-East, the SMB segment has yet to embrace e-commerce. In a recent survey done by Deloitte and TNS in Qatar, it averred that only six percent of SMBs interviewed sell goods and services online across industry sectors, with the key barriers to adoption being security concerns, lack of funds and lack of IT skills.

Figure 1 - e-commerce behavior in the UAE



Note: UAE - % of total (sample = 430)

Note: UAE - % of online transactions - multiple responses were allowed (sample = 71)

Source: Arab Media Outlook 2011-15. Published in April 2012.

Weak links in the regional e-commerce value chain

A deeper dive into these adoption gaps from a demand and supply side uncover some critical missing links in the regional e-commerce economic system. Three core enablers are essential to ensure a vibrant e-commerce market: good logistics, fit-for-purpose regulation and effective payment gateways.

While there are strong differences from country to country in the region, it is fair to say that the Middle East has yet to develop a more robust position on all these three enablers. Logistics and delivery services often hinder the growth of e-commerce due to the difficulty to coordinate home delivery with the existing postal system and, in many markets, the uncompetitive nature of domestic delivery. It is not surprising that the countries with the highest penetration of e-commerce also enjoy the availability of alternative delivery providers such as Aramex. Regarding regulation, "e-laws" in the region have undeniably progressed over the past few years with a number of markets implementing the necessary digital policies including e-commerce and data privacy laws. Again, for regional e-commerce players, the challenges lie in the diverse legal structures from country to country and the relatively recent adoption of these laws (e.g. Qatar passed the e-commerce law in 2010) resulting in lack of awareness and enforcement mechanisms. The last enabler, payment gateways, is proving to be an issue primarily from an affordability standpoint. Merchant Service Commissions and cost per transaction in the region tend to be on the high side when compared to international standards and the set-up and annual fees for the service are usually prohibitive for small and medium businesses.

The good news for e-commerce in the region is that the local market has been creative in finding solutions to the shortcomings of the traditional e-commerce value chain. Aramex has worked very closely with e-commerce providers such as Souq.com and, more recently, Namshi to optimize the inventory and delivery logistics. On the payment front, Cash-on-delivery has proven to be a good (if not sustainable) interim solution to the lack of credit card adoption and trust in online transactions. Still, today close to 70 percent of all orders in the Middle East are done on a Cash-on-delivery basis. In the same vein, pre-paid card payments of online orders have been a potent alternative to credit cards to the extent that a regional, homegrown company, CashU, developed a successful business model out of it.

The better news for the region is that a new generation of entrepreneurs is leading the transformation of the regional economy into the digital age

The better news for the region is that a new generation of entrepreneurs is leading the transformation of the regional economy into the digital age. The survey conducted in Qatar by Deloitte and TNS, showed that local SMBs in their growth phase (2 to 10 years of existence) are twice more prone than average to the adoption of e-commerce activity. These young companies share some common traits – a strong belief in the benefits of technology adoption, a willingness to develop beyond borders and just enough cash to start investing in future growth. Should the region overcome the current limitations of its e-commerce environment, there is no reason to doubt that the Middle East will continue to experience high double digit growth in e-commerce in the coming years.

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