KEARNEY مكاتفة mukatafa

The Impact Of Cross Border e-Commerce In KSA

This paper is a product of a mutual collaboration between Kearney, a leading management consulting firm, and Mukatafa, the only organization in the KSA working toward the collaboration and integration of public and private sectors

Executive Summary

This study analyzes the state of ecommerce in Saudi Arabia, particularly the role of cross-border ecommerce, which currently represents approximately 60% of the ecommerce sales.

Industry leaders in local ecommerce platforms believe cross-border players have a price advantage on same quality products due to differences in the cost of doing business. Local players have 17-26% higher like-to-like cost of servicing than their cross-border peers. Cross-border ecommerce players are only subject to customs duty on shipments valued over SAR 1000 and are not subject to VAT, corporate taxes, Zakat, and quality compliance certificate and permissions, which local companies have to comply with. The consumers see this translating into a price gap, which is the key driver to prefer cross-border.

The ecommerce market in KSA has rapidly grown with the support of changing consumer preferences during Covid-19 and government initiatives under Vision 2030. It is expected to reach 7.6% of the overall retail market by 2026 with 13% CAGR. There are three types of ecommerce value chains: cross-border, local, and hybrid. Cross-border players such as Aliexpress and Farfetch have limited or no local presence, investment, or direct employment in destination countries like KSA. Local players have domestic presence, investment, and employment in destination countries, while hybrid players like Amazon operate both locally and cross-border.

In KSA, cross-border ecommerce accounted for 59% of all ecommerce revenue in 2021; however, there has been a steady decrease of cross-border ecommerce penetration between 2017 and 2021 due to the increasing ecommerce penetration in the retail sector, customers' increasing tendency to shop online, and development of local ecommerce players. Cross-border sales will continue to be a major contributor as current regulations create an unbalanced playing field.

To create a level playing field for all ecommerce players while protecting consumer interests and promoting local investments, this paper proposes four key initiatives to consider, based on learnings from other markets: reducing the minimum duty threshold (SAR 1000 currently), reviewing and overhauling tax laws for foreign organizations and individuals, implementing a threshold on import quantities and making it mandatory for cross-border players to comply with local quality standards.

Introduction

KSA’s ecommerce market potential

KSA’s 19.3 B SAR (2021) rapidly growing ecommerce market is ~6% of the overall 347.2 SAR Bn. retail market and expected to reach 34.7 SAR Bn. by 2026 (7.6% of 2026 overall market)

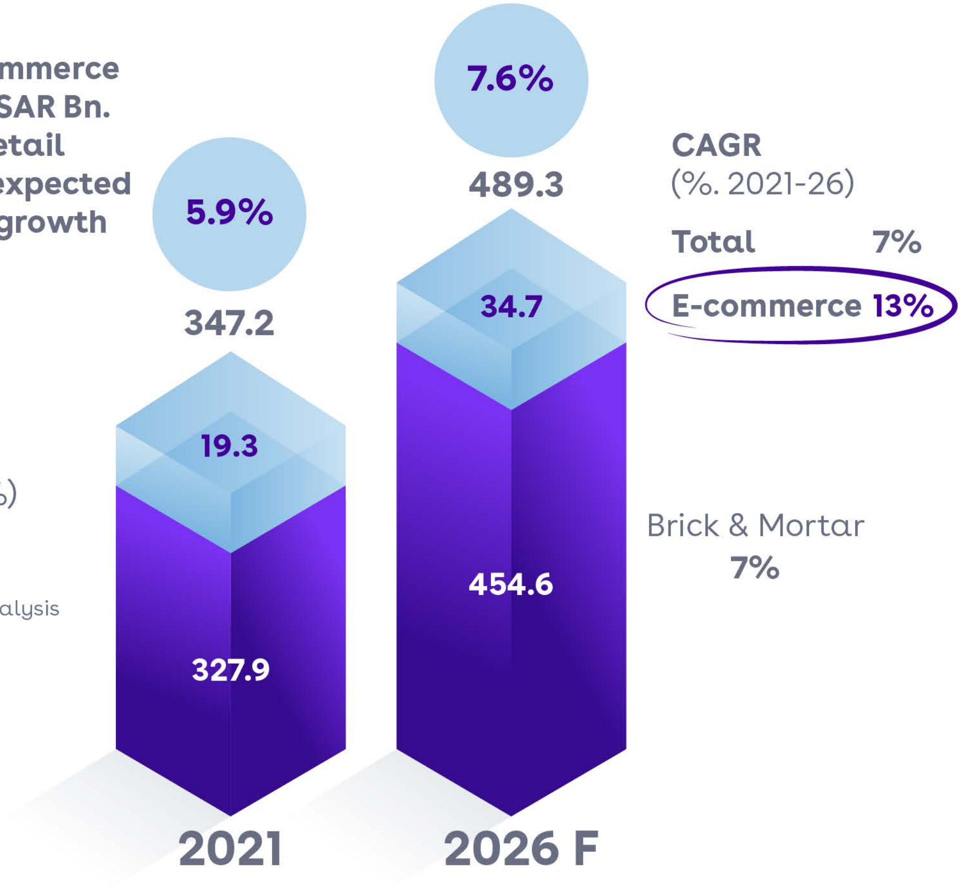
(See Figure 1). **Why are we so optimistic?**

Figure 1
As of 2021, size of ecommerce market in KSA is 19.3 SAR Bn. and it will drive the retail sectors growth with expected 13% average annual growth rate between 21'-26'

Retail market size
(KSA SAR Bn.)

% E-commerce share of retail (%)

Source: Euromonitor, Kearney Analysis



Covid-19 forced KSA consumers to adopt digital purchasing, facilitated by nearly universal Internet access **(98%+ of KSA have internet access)** and a flourishing ecommerce ecosystem that empowers them to use innovative digital payment methods ranging from digital wallets to crypto to Buy Now, Pay Later – and others.

Government initiatives under **Vision 2030** guide private sector investments to provide the critical pillars for ecommerce growth such as increasing cashless transactions, stabilizing, and diversifying the financial sector, and expanding the geographical coverage of ecommerce delivery beyond the major cities to all regions in Saudi Arabia

As consumers continue to increase online shopping, the role of cross-border ecommerce, which sells and moves goods across national borders between enterprises and consumers, represents a significant **(~ 60% of ecommerce sales)**, but not equal, commercial opportunity.

This paper analyses key areas which need to be addressed to create a level playing field for all ecommerce players, while protecting consumer interest & promoting local investments.

Three roads to one destination

How cross-border, hybrid, and local ecommerce value chains work

Cross border value chains can be highly complex, translating into long lead-times and high delivery costs. Many of these players such as Aliexpress and Farfetch have limited or no local presence, investment, or direct employment in destination countries such as KSA. Most goods sold are manufactured and warehoused in source countries then packed and shipped to destination countries. After goods arrive at their destination country and clear customs they are delivered to buyers by domestic routing and transport firms. (See Figure 2).

Figure 2:
In typical cross -border ecommerce, custom clearance occur after the product sales is completed unlike localized ecommerce

Typical cross-border ecommerce supply chain

Source: Kearney

In contrast, local ecommerce companies have domestic presence, investment, and employment in destination countries like KSA. Goods are manufactured locally or in other countries but shipped and stored in destination country warehouses and retail stores. Orders are domestically packed and shipped to customers via local courier companies.

Finally, there are hybrid players such as Amazon, usually large ecommerce companies operating both locally and cross-border in the same market to satisfy local customer demands. For example, Amazon might ship available products from its KSA warehouse or locally unavailable ones via Amazon UK / US / etc.

Cross-border ecommerce in KSA

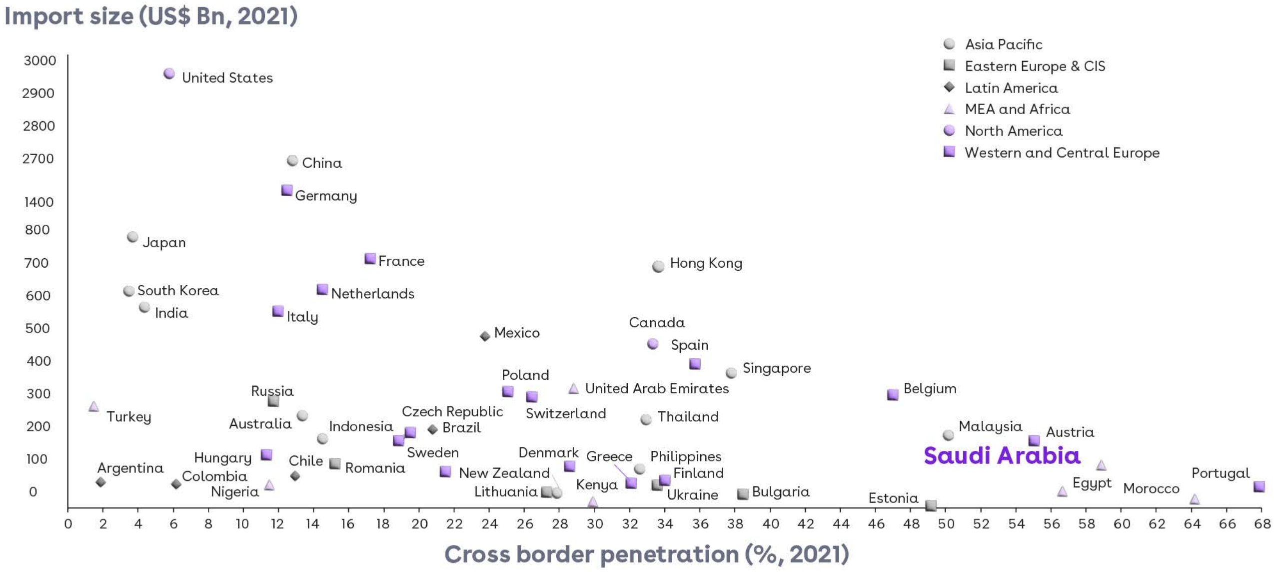
In many countries, including KSA, digital marketplaces are dominated by players from the US, China, and Europe who invested early and heavily in developing transnational and global ecommerce infrastructures before local economies could organically grow their own digital businesses. This leaves local businesses battling on regaining domestic digital market share lost to international competitors.

Let's look at what all this means for KSA – today and in the future:

Last year (2021), cross-border ecommerce accounted for 59% of all KSA ecommerce revenue, the third largest share of cross-border activity among key countries evaluated (see Figure 3). Looking at historical trends, we see a steady

Figure 3
Compared to the global benchmarks, KSA has one of the largest cross border share within ecommerce retail

Share of cross-border within overall ecommerce vs import size for selected countries (2021)



Source: UN Comtrade, Oxford Economics, Euromonitor, Kearney analysis

Decrease of cross-border ecommerce penetration between 2017 and 2021 (14pp), as a result of increasing ecommerce penetration in the retail sector, customers' increasing tendency to shop online, and development of local ecommerce players.

In recent years, as businesses reached scale within the Kingdom, many cross-border ecommerce players have found it more efficient to invest in infrastructure in the Kingdom rather than ship cross-border. In March 2022, for example, noon.com launched a new 45,000 square meter Customer Fulfillment Centre in its warehouse in Riyadh. This trend is expected to continue with estimates suggesting 2026 cross-border ecommerce penetration will decrease to 49%. According to a survey conducted by Kearney and Mukatafa, consumers are also becoming more aware - 74% of respondents expect to increase purchase from Saudi ecommerce platforms compared to increase in purchases from China, GCC and Europe & US (see Figure 4). That said, since current KSA regulations still favor cross-border players, cross-border sales will continue to be a major contributor.

Figure 4
Although share of cross-border ecommerce is expected to decrease by 2026, it will still continue to be major with 49%

Share of cross-border within Over ecommerce

Origin of ecommerce platforms where consumers expect to increase spending in the next 3 years (Share of respondents %)

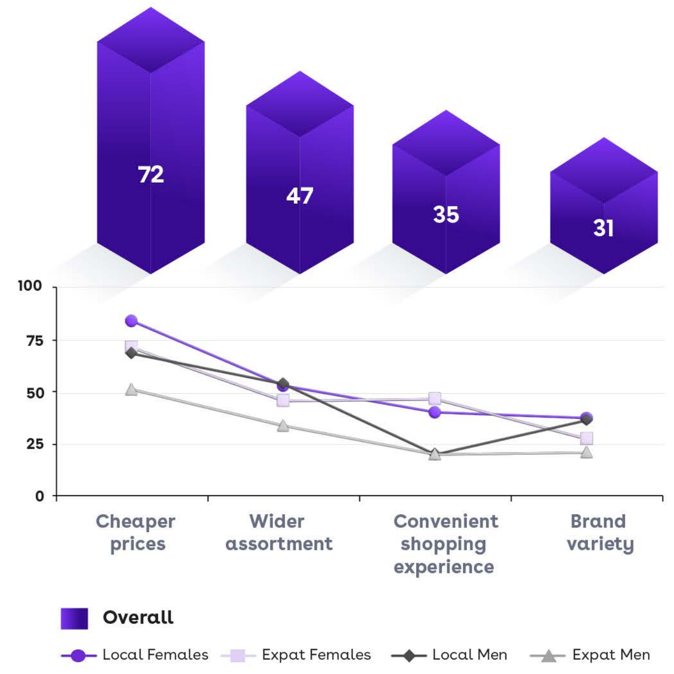
Source: Statista, Potloc, Kearney Analysis, Primary research n= 637 Q: In the next 3 years, all product categories combined, to what extent will you buy online from each of the following countries or regions?

Consumer preference on cross-border ecommerce

Seventy two percent of respondents prefer cross-border players' lower prices – cited by 84% of local women, wider assortment (47%), convenience (35%), and brand variety (31%). Negative factors included high shipping costs (59%), longer delivery (55%), 51% potential scams and 44% quality problems. (see Figure 5)

Figure 5
Cross border players are favored for their cheaper prices and wider assortment while high shipping costs, long delivery and potential scams are their main drawbacks

Elements encouraging cross border commerce
(overall, % of respondent)



Elements encouraging cross border commerce
(overall, % of respondent)

Industry leaders in local ecommerce platforms believe there are two primary reasons for the price differential.

Q: Over the past 12 months, what elements encouraged you to make online purchases of physical goods from companies based outside the KSA?, According to you, what are the main drawbacks of purchasing online physical goods from companies based outside the KSA?
N: for overall=637, for local women= 283, for expat women=135, for local men=69, for expat men=150
Source: Potloc, Kearney, Consumer Research

Firstly, the cost of doing business gives cross-border players a ~20% price advantage on same quality products'. Local players have 17-26% higher like-to-like cost of servicing than cross-border players (See Figure 6); 6-7% due to custom duties, 4-7% due to corporate taxes and Zakat, and the rest due to quality compliances and compliance to Saudization (10-12%). Currently cross-border ecommerce players are only subject to customs duty on shipments valued over SAR 1000 and are not subject to VAT, corporate taxes, Zakat and quality compliance certificate and permissions (i.e. SASO, SABER) which local companies have to comply with (see Figure 7).

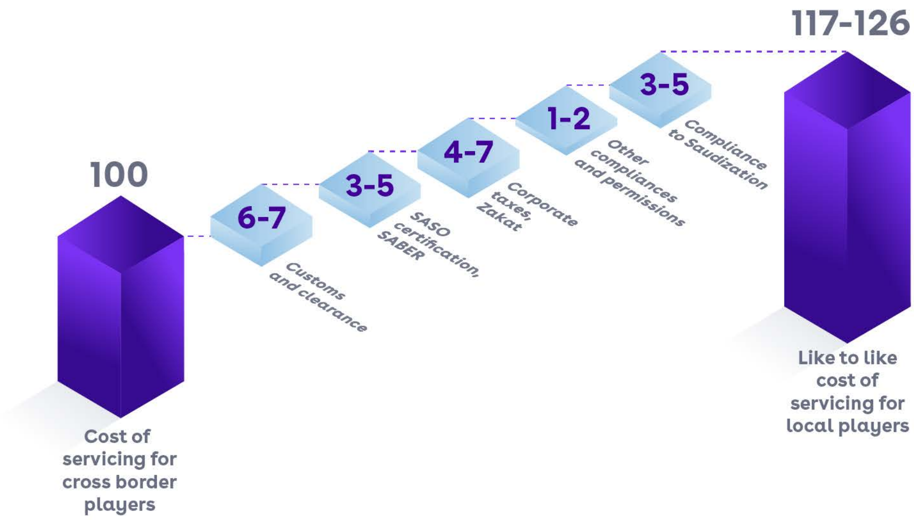


Figure 6
Like to like cost of doing business is 17-26% higher for localized ecommerce players than cross-border

Source: Mukatafa, Kearney

Figure 7
local ecommerce players comply with local regulations, they are not mandatory for cross-border players

Local regulations for e-commerce in KSA

	Cost to Companies	Localized E-Commerce Players	Cross Border E-Commerce Players
Duties and Taxes			
Custom Duty	i.e. 5% on apparels1	✓	✗ Over 1,000 SAR only
VAT	15%	✓	✓
Corporate Taxes	20%	✓	✗
Quality Compliance			
SASO	SAR 2,700 per product line	✓	✗
SABER	SAR 408 per product line	✓	✗
SCOC	SAR 455 per shipment	✓	✗
SFDA	SAR 5000 per year	✓	✗
Permission			
Sales/Discount Permission	SAR 300 per event	✓	✗
Other Licenses and Permits2	Per licence	✓	✗

✓ Companies need to comply with the regulation
✗ (light) Companies partly need to comply with the regulation
✗ Companies partly don't need to comply with the regulation

1. Irrespective of consignment value
2. Includes CR, Civil Defense and Baladiya License

Source: Mukatafa, Kearney

Secondly, especially Chinese cross-border players' products can be in lower quality and at lower cost. There are also incidents of counterfeit goods, mostly prevalent in the Health & Beauty and Electronic categories.

Additionally, industry leaders believe they need to enlarge their assortments. Costs associated with quality requirements and certificates make it difficult for local players to broaden assortment by importing different products, while cross-border players can ship a greater variety of products anytime since they do not have to pay for certificates.

Lastly, industry leaders noted the need to create seamless customer experiences, upgrade their technological infrastructure, and the growing importance of the post-purchase experience – delivery, customer service, and advocacy.

Implications for the KSA economy

Taken together, the cost of doing business, limits on creating variety, and quality issues significantly disadvantage local players and affect customer satisfaction and safety. Additionally, there are five direct negative consequences of the current situation:

Unemployment increase in KSA:
KSA's 2020's overall unemployment rate was 7.7%. Cross-border ecommerce also threatens the development of the Saudi retail sector. Every one billion SAR of sales shifting from offline to online translates into a direct job loss of 600-1600 people, most of it uncompensated.
Local players capture only 40% of the overall market and employment flows to cross-border players.

JOBLESS

600-1600

every 1b sales shift results in 600-1600 job losses

Revenue to KSA government:
With current regulations, approximately 10% of cross-border sales is a revenue loss for KSA exchequer on account of customs, taxes, certifications etc. It means that in 2021, if cross border players' penetration was 10-12% (based on developed country benchmarks) instead of 59%, KSA exchequer could generate additional 900-950 million SAR. This loss revenue could go up to 1.3 billion SAR in 2026.

SAR **1.3** billion SAR

loss revenue could go up to 1.3 billion SAR in 2026.

Consumer safety:
It's critical to regulate product quality. as 50% of the respondents on our consumer survey report quality as an issue. This is an important consideration for the Government as it must balance the need for protection / safety over choice. The KSA government has established stringent ecommerce regulations around quality compliances and permissions in place such as SASO, SABER, SFDA, etc. For instance, a Certificate of Conformity (CoC) issued by SASO is required for all imported products to ensure adherence to all necessary product safety and quality requirements. However, the current model has the potential of diluting customer safety and protection as cross border players do not have to comply with local quality certifications.

CoC
Is required for all imported products to ensure adherence

Investment:
The ecommerce market is expected grow ~16 Bn. SAR until 2026 which requires heavy investment especially in local players (which is estimated at SAR 3-4 Bn). With cross border model, negligible investments occur in KSA – hurting long term potential of the local industry development.

~16 billion SAR
Ecommerce marketis expected grow ~16 Bn. SAR until 2026

Upskilling:
Lower investments in KSA's local ecommerce and lack of level playing field for local players can also result in insufficient investment in KSA's talents in high-value adding areas like technology, AI, digital marketing etc. Competitive disadvantage of local players can incrementally grow with lack of skilled talents against cross border players and a significant share of the job losses can be made up.

Impact on brick-and-mortar stores:
Cross-border ecommerce websites can pose a significant threat to brick-and-mortar stores, as they often offer articles at lower prices due to fewer associated costs.
The absence of level playing field can encourage consumers to opt for cross-border ecommerce websites, ultimately leading to a negative impact on physical stores in the Kingdom

Potential recommendations to navigate this situation in the KSA

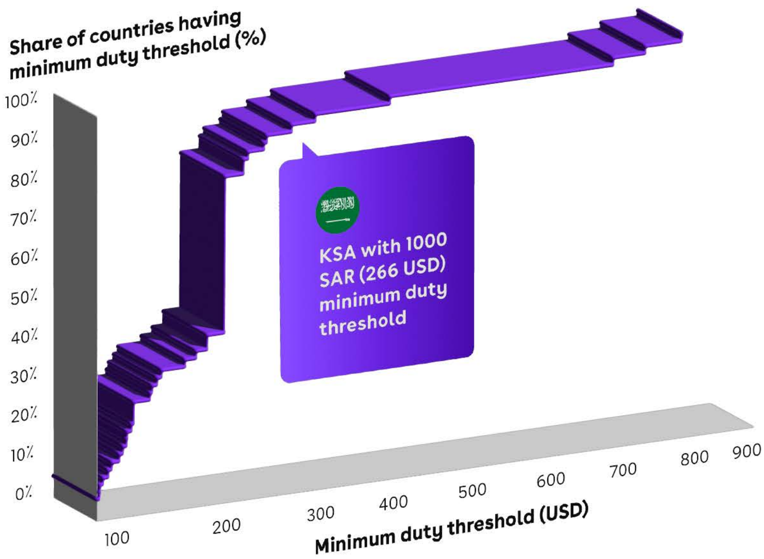
To protect local ecommerce and create a level playing field, we suggest four key initiatives:

1.Consider reducing the 1000 SAR (266 USD) minimum duty threshold to make more cross border eligible for import duties

According to 57 benchmark countries, majority put their thresholds either lower than 50 USD (28% of countries) or between 150-200 USD (42%). The KSA threshold is 1,000 SAR (266 USD), almost 90% higher than the countries studied (see Figure 8) which indicates a significant room for improvement. However, to determine optimal level of minimum duty threshold, further analysis on cross border ticket sizes should be conducted. The level that will discourage to shop from cross border but will not put heavy operational pressure on customs and not hurt consumers greatly should be identified.

Figure 8
KSA has higher minimum duty threshold more than almost 90% of studied countries

Minimum duty threshold of countries
(57 benchmark countries, % vs USD)



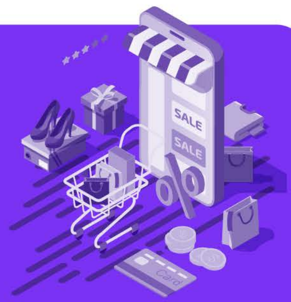
Source: Global Express Association, Kearney Analysis

This initiative has been implemented in four different ways in several other countries:

- **Reducing threshold (duty or VAT/GST)**
  Benchmark countries (historic and current thresholds):
  UAE (1,000 AED to 300 AED), Ukraine (150 EUR to 100 EUR),
  Russia (1,000 EUR to 200 EUR), Indonesia (75 USD to 3 USD)
  and India (150 USD to 4 USD)

- **Eliminating threshold (duty or VAT/GST) reducing threshold to zero**
  Benchmark countries (historic thresholds abolished):
  Australia (750 USD GST threshold), EU/UK (22 EUR VAT threshold) and Turkey (30 EUR duty threshold)

- **Increasing duty or VAT/GST amount (%) in certain categories**
  for example in apparel, shoes accessories, health and beauty, electronic accessories, supplements which have higher cross border penetration in KSA.
  Benchmark countries: Indonesia (i.e. all duty and taxes combined, initial price can go up to 70-75% in shoes)

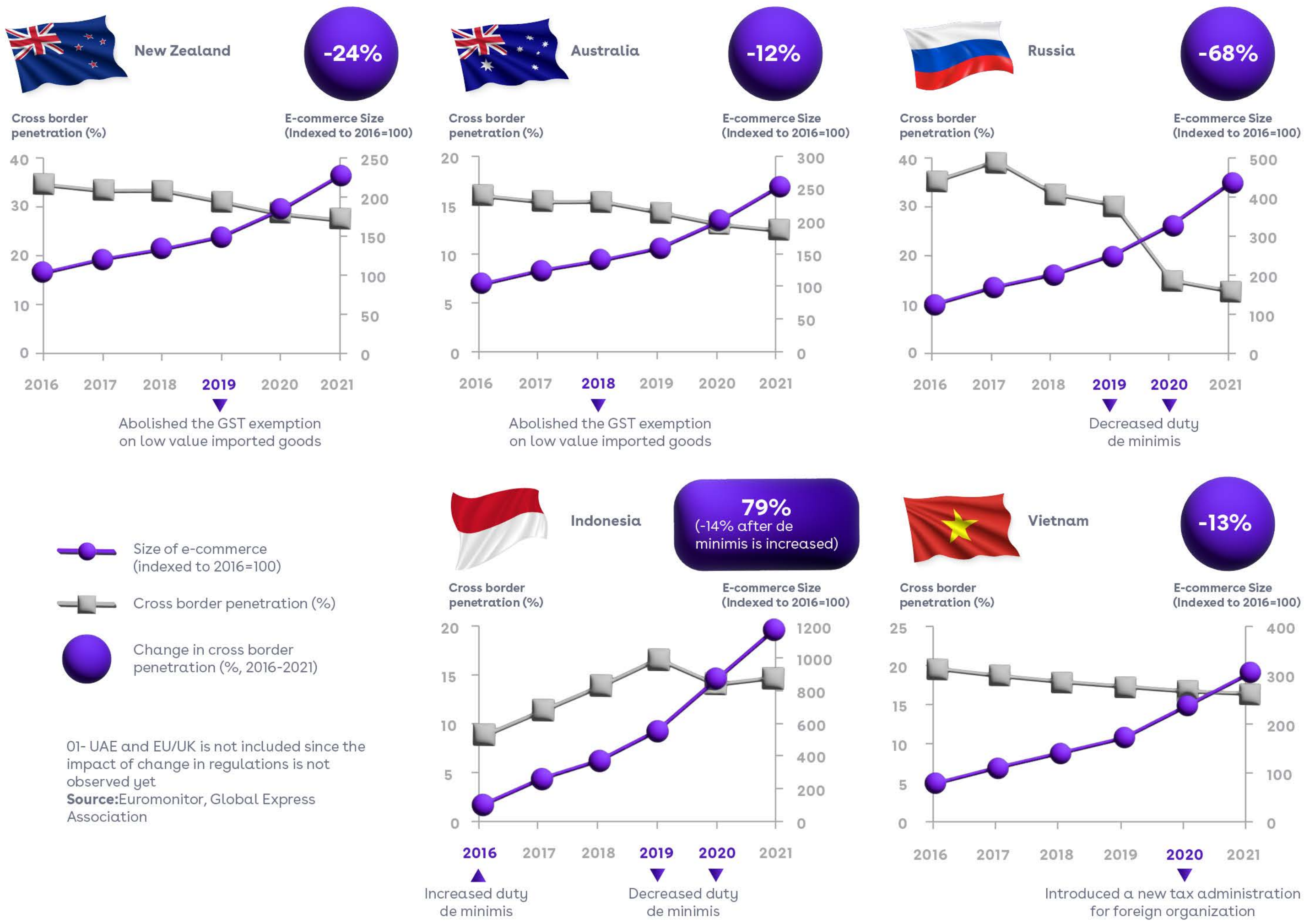


- **Eliminating minimum threshold of duty for companies with revenue from KSA above a certain threshold**
  Benchmark countries: Australia (above ~52,200 USD annual revenue), New Zealand (above ~42,200 USD annual revenue)

Looking at the impact of changes, direct increase in share of local ecommerce is observed after the above regulations taken into place. While overall ecommerce size is not hurt, cross border share is decreased after the regulations take place. (See Figure 9).

Figure 9

Stricter regulations to cross-border directly reflects as increased local player activity without damaging the size of overall ecommerce market according to benchmark countries



However, there are few downsides. Consumers that still prefer to shop from cross border are negatively affected as extra duty amount is directed to them.

Additionally, reducing the threshold can increase number of operations in customs and prolong custom clearance durations. In order to minimize the effects, some countries prefer to implement the initiative on certain products or companies (as in bullet 3 and 4).

1. UAE and EU/UK is not included since the impact of change in regulations is not observed yet
Source: Euromonitor, Global Express Association

2. Reviewing and overhauling of tax laws for foreign organization and individuals

which earn revenue from destination country through ecommerce without having a permanent facility in destination country – higher taxation implemented

Benchmark countries: Vietnam, Kenya

By enforcing cross border companies to pay taxes as local companies, cross border players' cost of doing business increases as local companies, and it creates a step forward in level playing field. Impact on consumers will be lower in this initiative compared to decreasing the duty threshold since corporate taxes and zakat creates usually 1-2% lower cost to companies. Even this additional cost on companies is reflected to consumers, the price increases will be lower.

Higher Taxation

which earn revenue from destination country through ecommercewithout having a permanent facility in destination country – higher taxation implemented

3. Implementing threshold on import quantities (per delivery / receiver) on certain categories

for example on apparel, shoes accessories, health and beauty, electronic accessories, supplement which have high cross border ecommerce penetration in KSA

Benchmark countries: Indonesia

Impact on individual consumers is lower in this initiative since they are not expected to be affected with their low volume. However, it prevents small businesses to illegally import goods from cross border players and dump into the local markets

Implementing threshold

for example on apparel, shoes accessories, health and beauty, electronic accessories, supplement which have high cross border ecommerce penetration in KSA

4.Making it mandatory for cross-border players to comply with local quality standards

(for example SASO, SABER, etc. in KSA)

Benchmark countries: Indonesia, Egypt, India, US and UAE

In countries including Indonesia, Egypt, India and US, cross-border players and local businesses must comply with the same quality compliances. ZAD & Halal Registration mandatory for cross border ecommerce companies as well as local players in UAE.

SASO is currently working on such initiative and expect to finalize it towards midst of 2023. Although details of the initiative are not publicly announced yet, increased emphasis on individual ecommerce packages is expected to reduce number of high-risk and counterfeit products shipped by cross border players. Additionally, quality standards hold lower share within cost of business compared to custom duty and corporate taxes, therefore monetary impact on consumer is expected to be lower.

Comply with local quality standards

for example SASO, SABER, etc. in KSA

Conclusion

KSA's ecommerce market promises high potential with 13% compounded annual growth rate in the next 5 years. However, leveling the playing field against cross border players is the key to support development of local ecommerce platforms and unlock growth opportunities.

Cross-border ecommerce is leading to multiple socioeconomic negative consequences in KSA such as increased unemployment (or lower job creation), revenue loss for the government, dilution of consumer safety, and a lack of investment and upskilling in the local industry. Cross-border ecommerce also poses a threat to brick-and-mortar stores.

13%

KSA's ecommerce market promise high potential with 13% compounde

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From August 16th to August 23rd, Potloc used its social media sampling technology to survey 500 respondents residing in the Kingdom of Saudi Arabia. The respondents consisted of 350 Saudi adults & 150 expats who have online shopped in the past 12 months. The average survey completion time was 6:16 minutes and no incentives were used to collect the data.

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