

SACHA ORLOFF GROUP

Saudi Arabia Retail Prospects and Outlook for 2012

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Saudi Arabia - Retail Prospects and Outlook for 2012

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Saudi Arabia - Retail Prospects and Outlook for 2012

Immense opportunities in the fast growing retail market in Saudi Arabia – its constraints and challenges.

The Middle East Retail Sector forecast for 2013 has identified Saudi Arabia and the UAE as the markets with the most potential and dynamic retail sectors in the region. These two markets have sustained their dominance within the retail landscape for more than a decade and will continue to do so in coming years. The presence of a large expatriate population and the majority of region's retail investment being centred in these countries have helped to maintain the growth momentum.

The GCC retail industry is poised for a healthy growth and known to be one of the fastest growing sectors in the Middle East. It is the second largest sector in the oil-rich GCC region, and is considered to be the most favoured means of endorsing diversification and continual economic development in the area.

In general the Saudi retail sector is spread across malls that have mainly replaced the old markets and souks all over the Kingdom. Malls attract consumers to purchase in a more modern and stylish environment; enabling to build a consumer experience with both a social and entertainment purpose.

1.0 The Kingdom of Saudi Arabia economic landscape

The Riyadh-based Jadwa Investment has projected that 2012 will be another year of stable economic performance for Saudi Arabia. A stable and steady economic growth climate has been supported over the last decade through initiatives that encourage economic diversification to generate a more competitive business climate. The expansion of certain industrial sectors such as services and retail have been strengthened due to a continued growth in trade with Asia, and the opening of trade channels with the wider Middle Eastern region. The dynamism of the services and retail sector will continue to remain strong as integrated initiatives within the GCC provide opportunities for growth.

- Jadwa projects that the Kingdom's GDP growth will fall to 3.1 percent in 2012, from 6.8 percent in 2011. This sharp decline in GDP is based on the expected decline in oil production stemmed from high prices and over-capacity in 2011.
- Growth in the non-oil economy is forecasted to reach 4.7 percent. The non-oil sectors will be bolstered by greater bank credits and high consumer spending, although this will sustain inflationary pressures.
- According to the United Nations, demographic growth will continue rising by 2.0 percent per annum for the next three years, led by an urban population growth rate of 2.2 percent versus 0.7 percent for the rural community showing a significant increase in urban migration. It is expected that the population will rise from 26.5 million to 28.6 million by 2015, with 45% of the population aged between 19 and 45.
- In Saudi Arabia, the Gulf's most populated state, retail accounts for more than 17 percent of the country's total GDP. The kingdom expects retail spending to top SR256bn (\$68bn) by end-2011, more than twice the size of the UAE market. This compares with figures below 10% in all other MENA markets. ⁱ¹

¹ (<http://www.arabianbusiness.com>, 2012)

- Retail sales per capita in the kingdom continued to move upwards during the downturn, and are likely to reach SR15,274 (\$4,078) by 2015 50% from 2010 of SAR 9,963 (US\$2,660).²

1.1 Total retail spending in KSA 2011:

The Saudi Arabia Retail Report forecasts that the country's retail sales will have reached SAR256.13bn (US\$68.39bn) by 2011³. The principal factors behind the forecasted growth in Saudi Arabia's retail sales are:

- Strong underlying economic growth
- Rising disposable incomes
- Increasing acceptance of the concept of modern retailing
- A youthful population and an enlarged consumer base created by the improved position of women in society

1.2 Total retail spending in UAE 2011

In 2011, Dubai Shopping Festival (DSF) contributed of Dh15.1b (US\$4.10bn) to the Dubai economy in 2011. The boost to Dubai's economy from retail, travel and hospitality spend during the festival totalled Dh15.1 (US\$4.10bn) billion — Dh5.9 billion (US\$1.6bn) spent by regional and international visitors, and Dh6.6 billion (US\$1.79bn) spent by residents of other emirates,⁴

1.3 Total retail spending at Dubai Duty Free

Dubai Duty Free reported to have achieved its sales target for 2011 with sales of Dh5.31 billion (US\$1.44bn) in the year, a 15.69 per cent increase over the previous year.⁵

1.4 Global GDP growth ⁶

	2008	2009	2010	2011f	2012f
US	3.8	-0.3	1.6	3.0	1.2
Japan	1.4	-1.4	-0.7	-0.4	-0.5
EuroZone	2.0	0.9	0.8	1.4	1.4
UK	3.6	2.1	3.3	4.5	2.4
China	5.9	-0.7	3.3	5.5	3.3
Emerging Markets	9.2	5.2	6.1	7.5	5.9
Middle East	13.5	6.6	6.8	9.9	7.6

² (<http://www.arabianbusiness.com>, 2012)

³ (Monitor, 2011)

⁴ (<http://www.emirates247.com>, 2012)

⁵ (<http://gulfnews.com/business>, 2012)

⁶ (Jadwa Investment, 2011)

2.0 Global Trends

The retail sector has transformed into a global market, with a growing number of international brands, investors and developers. Factors that have affected the globalization of the retail sector include the rapid transformation of the industry as a whole; the rapidity of the market; new strategies enabling entry into emerging markets and shifting business models.

It is paramount for owners, CEOs and managers to re-think and re-structure their actual strategies into winning competitive factors of differentiation. This requires a transformation of organizational identities and business models through new strategies. Both retailers and landlords need to adapt rapidly to these new factors as to not become casualties of the new retail environment.

The current situation leaves no room for abiding to the status quo. Radical changes are happening in the wider Gulf region. In Dubai for example, some retail holdings are restructuring their tenant leasing policies to benefit from repositioning and leasing to more profitable leaseholders.

This is particularly prevalent in retail where following the success of Dubai Mall and Mall of the Emirates, many smaller and older players have to quickly adapt to changing consumer patterns. This example is valid for any older malls in the GCC region, where the aspect of leisure and lifestyle attraction has not been adequately integrated into the infrastructure offered to consumers.

Luxury-sales growth in the world's most populous nation China will slow down in 2012, forecasting at least a 20 percent slowdown this year, with its impact already being felt by international luxury brands. This drop signifies the end of the high-growth and highly profitable era of for many luxury goods retailers. It is expected that sales growth at high-end stores may drop by as much as six percentage points in 2012 according to the Royal Bank of Scotland.

Due to the economic slowdown and market decline, consumption has levelled off faster than anticipated. However, future growth of the retail sector will continue to give preference to the middle class demographic segment whom will provide the most disruptive opportunities in emerging economies.

2.1 Key Trends in the MENA retail market

The retail sector in the GCC and wider Middle Eastern countries witnessed tremendous growth over the past years. Due to the implementation of government's policy frameworks and the increasing contribution of the private sector to GDP growth, the region has become one of the world's most pursued retail locations. The growing importance of the Middle East in the retail sector can be attributed to its revenue generation potential particularly for retailers seeking new diversification opportunities.

Factors that have propelled the Middle East as a core retail market includes:

- Transformation of the market dynamics,
- Rapid economic development,
- Strength of crude oil prices,
- Rising purchasing power,
- Younger and more affluent demographic,
- Strong consumer confidence is consolidating the region's retail sector.

Countries such as Egypt, the UAE, Turkey, and Saudi Arabia have recorded outstanding market expansion due to the shift of consumer demographics, a strong presence of expatriate population, and high purchasing power. However the UAE controls the regional retail real-estate scene. Dubai, Abu Dhabi and Sharjah are key retail markets in the nation with substantial presence of modern retail outlets and lifestyle shopping attractions. The GCC markets are sustaining their authority in the retail landscape and most certainly will continue in the coming years, if they embrace changes and comply with the trends.

Macroeconomic factors critical to retail investment in these countries have enabled a rapid growth impetus in the retail sector in the entire Middle Eastern region. However this industry has to monitor continuously the trend, which will decide the future of the retail sector in the region.

2.2 Trends in the Saudi real estate and retail market

Saudi Arabia expects another year of reasonable economic performance in 2012. Non-oil growth will remain strong and the inflation should ease. High government spending will remain the engine of the non-oil economy. Total population has grown at CAGR of 3% over the past decade and is expected to continue rising at a nearly similar pace over the next 5 years.

The real estate market is expected to profit from positive economic indicators such as oil prices and the Kingdom's overall real GDP, which will grow by 7.3 percent in 2011, up from previous forecast of 6.9 percent.

- The prevailing financial climate also offers a strong opportunity for forward-looking organisations to strengthen their reserves and structure long-term growth plans.
- The government has announced that it will be spending SR250 billion in the housing sector over the next 10 years.
- The positive outlook is strengthened by the government's stimulus package to aims to invest significant public expenditure into a broad range of public sector development and infrastructure projects.
- Development of large scale projects such as the King Abdullah Financial District and the formation of economic cities will ensure the region's largest real estate markets will continue to move forward and offer large opportunities for growth.
- Sale prices and average rentals are expected to rise in 2012 due to inflation linked to the government's economic stimulus package.
- The performance of the Saudi real estate market is due to the growth of its young population, large economic base, and the Kingdom political stability, aiming to employment among Saudi nationals and invest in skills development.
- The current housing stock stands at 876,000 units with another additional 132,000 units from now through to the end of 2015.⁷
- Average rental prices in Riyadh will continue to fall in spite of the strong economy, due to new space coming into the market, although this trend is not duplicated nationally.
- Vacancy levels remained stable in 2011 Q3.

⁷ (<http://arabnews.com/economy/article546012.ece>, 2011)

2.3 Riyadh, the future capital of the retail sector

- Retail vacancy levels are bottoming out reflecting a constant trend from the last two quarters of 2011
- Total mall based retail supply is expected to reach around 1.3 million sq. m by the end of 2014, with the completion of a number of small centres and additions to existing malls.
- There will be a cap on the future supply of major malls during 2011-14, due to increases in rent in major malls in the main cities of Saudi Arabia.
- Increasing demand for good quality products and family orientated malls providing unique shopping and lifestyle experiences responding to the increasing youth market.
- Saudi Arabia, the wealthiest Arab state, has lagged the UAE on the growth of shopping malls and retail spending. Riyadh and Jeddah have retail space of 0.20 sq m per capita, less than that seen in Bahrain, Qatar or the UAE, in part because of the market's unique cultural restrictions.

3.0 Key impacts on the retail market in KSA

Worldwide, the consumer culture can be acknowledged as the most significant and defining feature of modern day existence expressed through the acquisition of goods for the purpose of status and novelty seeking.

One of the definitions of the Saudi consumer culture may be understood as a pattern of values, meanings and customs shared by a group of people which adhere to the act of buying goods as part of a lifestyle and cultural activity, and not only driven by practical or economic factors. Where meeting others, being seen and getting to be recognised amongst their peers in the social ladder is a part of one's identity.

However this definition in Saudi Arabia has some unique implications within the retail business due its key differentiations.

3.1 Cultural differentiations:

In Saudi Arabia there is an important variation within the definition of leisure shopping and retail challenges:

- In the Kingdom, retail and lifestyle leisure are different from any other part of the world, where cinema and non-religious music are not culturally recognized.
- Malls have family-only policy during most of the week, which restrain young single male customers to access easily these facilities.
- Restrictions on women driving constraints reach and access to shopping.
- Female restrictions to changing rooms in malls negatively impacts on purchasing.
- Cities and malls infrastructure need to accommodate the extreme heat in summer and provide a maximum entertainment factor for a lack of outdoor leisure facilities.

These key factors need to be addressed by retailers, and real estate owners in order to find different options and overcome these obstacles by:

Developing a diverse environment that gives the opportunity to live, walk, shop, play and work at close vicinity. A mix of hotels, apartments, pedestrian areas, museums, libraries, retail areas, as well as mono rail system.

Offering innovative cultural entertainment concept made to measure for Saudi Arabia, which will secure new entertainment options not only for children but for the entire family as well as for women or single men.

Integrating other community facilities such as health centres, libraries, leisure facilities, language schools, civic and religious functions within or around the retail centres and stress-free one stop destination.

The trend to copy and paste winning retail formulas outside of Saudi Arabia has led to incremental failures when applied domestically. Examples of these include:

Emaar, the real estate and retail developer attempted to export its luxury-styled housing units in Khobar and Jeddah, with Khobar Lakes development and Jeddah Gate. However, this has not had the anticipated success as it did not respond to the lifestyle habits of its key markets.

Saudi buyers are unimpressed, as they know that taking a successful model from one market and try to deploy it in another market is not automatically key to success. Made-to-measure in the GCC is crucial to achieve best results, as each and every country is an entity in itself and replication is the best way to failure.

3.2 Religious tourism

Saudi Arabia has the unique role as custodian of the Holy Mosques, which attracts worldwide a demand for pilgrimage of 1.8 billion Muslims.

- More than 2.5 million religious pilgrims are estimated to visit Saudi Arabia during Hajj celebration, whereas over 7 million perform the Umrha pilgrimage throughout the year.
- Makka Al Mukarramah and Al Madīna al Munawwarah have got the highest footfall statistic in the world.
- The Saudi Tourism Information & Research Centre reported an estimated amount of (SR25.9) billion spent by inbound tourism in Saudi Arabia, while the tourist trips expenditure recorded (SR25.6).

Table 1.4: Inbound Tourist Trips by Purpose of Visit and Quarter

Purpose of Visit	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total	Market Share (%)
Religious	490,974	707,492	1,574,612	2,094,308	4,867,387	44.9

Source: IVS 2010, MAS Centre, SCTA.

- Major infrastructure development programs are conducted in both Makkah Al Mukarramah and Al Madīnah al Munawwarah.
- The Saudi government is preparing the cities for increasing religious visitation with new upscale hotels, apartments and good quality retail outlets as well as shopping arcades. Both cities will directly beneficiate of retail spending from the millions of pilgrims visiting each year.

Recommendation

The consequences of these developments for retailers and their management are to use their strategies on seasonality, tourism, and sales focused on short-term strategies. . These retail spaces will have a high level of mixed tenants to cater and appeal to both local population and tourists.

3.3 Saudi Retail Market Concentration

The retail sector is leading from the front in Saudi's ambition to move away from oil dependency towards a diversified economy. The competitive landscape in the retail sector of Saudi Arabia is largely dominated by family businesses that have operations across a number of other sectors. In the same group of businesses also includes the largest shopping centre developers and landlords in the country.

Family-owned businesses have focused on acquiring exclusivity and franchise agreements with well-known international suppliers and brands. Amongst them, some large companies dominate the branded apparel market, each representing a considerable number of international franchises.

Their role is mainly concentrated in the distribution of labels and brands through franchises, and joint ventures. This strategy contrasts significantly to major European Groups such as LVMH, PPR and Richemont group, who own the totality or a majority stake in their portfolio of luxury brands.

In addition to these, there are a few smaller companies with just less than five to ten international franchises, and an important segment in the market is the small retailers who own one or more shops. With low overheads, these retailers are able to offer very competitive pricing on their products especially in the medium to low category.

Moreover, mall owners should concentrate on modern shopping malls anchoring state-of-the-art hypermarkets, remodelling older shopping centres to a more architectural environment, to create a sense of belonging and gathering.. This can be translated as well in various shopping festivals and events for the public to provide further growth impetus to the sector.

Smaller malls are becoming a growing trend, and should not be neglected with a shift towards urban community and convenience malls. Smaller shopping centre with approximately 10,000 sq metres of leasable retail space, showcasing quirky, new and up-coming fashion brands, gourmet grocery, car spa, and speciality home furnishing flanked with small, elegant restaurants and cafes, fashionable hairdressers, and inviting bookshops.

Recommendations and Gaps

In regard to new retail entrants, which are diversifying from their other family core businesses; for a successful penetration of the Saudi retail market, a new venture should focus on developing a business model that innovates and varies from that of the major groups operating in the region.

Differentiation: Use a strategy of differentiation, analysing the market gaps to grab the numerous opportunities in the actual Saudi retail market.

Avoid Saturation: Similarly linked to product differentiation, retailers must avoid saturating and cloning product ranges and retail concepts as this will lead to unsustainable growth.

Understanding demographics: Cater for the largest growing demographic which is the youth, which is not only a demographic but a mindset. Realise that with the demographic skew towards youth in the region, and take active measures to recruit young consumers before they get enticed by the competition.

The Saudi Chambers of Commerce should reinforce their retail business arm, which would enable all retail participants to engage and adhere to transparent retail policies, higher financial transparency and defined business conducts.

Saudi airports retail (duty free) should focus on an aggressive expansion of its retail business. There is such a gap of proper retail brands and shops in major Saudi airports, this opportunity to introduce retail could only lead to a robust growth in retail spending from its passengers, tourists and travellers.

3.4 Recruitment and customer service

A great effort has been applied to the current Saudization, better known as Nitaqat programme, which is positive for encouraging local hire, investing in the domestic population and lowering the unemployment rate among Saudi nationals.

As of early January 2012, over 28,000 Saudi women have come forward to take up jobs at shops selling lingerie and women's accessories throughout the Kingdom.

One of the critical success factors is the human capital, as employees play a key role in the overall operation of the retail business, and represent the retail concept to customers. They are also the first link to receiving feedback, and understanding the day-to-day opportunities and challenges which allows management to exploit strategic decisions.

Recommendation

- It is in the retail's market best interest to invest in the acquisition and retention of Saudi nationals. Not only will they be able to provide excellent customer service, but will ensure that the culture and 'social hub' is transmitted to clientele, who will feel more at ease. This will also significantly reduce training costs in the long-run, and as part of Nitaqat, will provide a career path in the service industry for nationals.
- All stakeholders will have to invest in training for their employees. This will enable to succeed in retaining staff and sales team with consistency in providing excellent customer service. Avoiding the employment of expats due to their tendency to work for short periods of time and responding to the language barrier would deter the highest levels of customer service.
- The stakeholders should realise the importance of the actual shortage of qualified national candidates which are truly suitable for providing immediate and future needs. This investment goes beyond customer service and into employee requirements across the entire retail chain, from logistic, supply chain to real estate.
- A culture of entrepreneurship would be recommended to empower the Saudi retail workforce to cater for growth, sustainability and survival of brands and retail concepts in a growing competitive environment.
- Customer service is a key differentiator and one of the main competitive advantages to retain and grow the customer base. In turn, the sales team should benefit from regular training opportunities to ensure the consistent quality of the service provided, and enable them to give feedback and suggestions to management for a pro-active approach. Results will be translated into customer loyalty, higher sales, and stronger financial performances.

4.0 E-Commerce in KSA is the next growing trend

The e-retail industry is finally beginning to gain steam in the Arab world amongst brick and mortar retailers.

Whilst the UAE leads in the GCC for e-commerce spending, with, according to Visa with sales close to \$2 billion, Saudi Arabia has the next largest share of the market, with an estimated \$520 million.

- Online sales in the Arab world are forecast to top US\$2 billion (Dh7.34bn) by 2016, amid a boom in e-commerce in markets including the UAE and Egypt.
- More people are in employment as the economy is improving, and have less time to physically go and shop.
- A report by Euromonitor International, the market research company, estimates that for three key economies in the Arab world – Saudi Arabia, the United Arab Emirates (UAE) and Egypt – Internet retail sites pushed past the \$1 billion for the first time last year.
- In all the GCC, E-commerce is a growing business, with a broader awareness of the do's and the don'ts.
- A study revealed that 61% of Internet users are going online to find out more about their products, while only 43% have made an online purchase.
- The gender breakdown is weighted slightly in favour of men, with almost half (46%) of men having made an online purchase, compared to just under a third (32%) of women.
- Young successful GCC entrepreneurs are launching their retail online business with increasing financial revenue by the year. A good example in the fashion industry is El Ilhaam, which will be the next Net-a-Porter of the Middle East and soon globally.
- The most surprising statistic, and one which hints at the optimistic outlook for e-commerce in the region, is that one in three Internet users in the Middle East purchase goods online.
- The main concern is credit card fraud, cited by 56% of the respondents.
- Another problem is the return policy of the product
- However, the most interesting aspect of e-Commerce for the Saudi female population is to be able to pick and choose the product in the comfort of their house and try it at home as well.

Recommendation

- There is still an immense void in the e-retail market in Saudi Arabia, and this market-share has to be grasped; the first entrepreneurs to succeed in this discipline will become the future leaders of the new e-retail industry in the region.
- Use the demographic advantage of the under 25s who dominate the online spending in the Middle East and the rest of the world.
- New e-retail tools are at disposition to Saudi retail entrants, and the focus should be influenced by and accounted for with social media, where social shopping is the trend.

5.0 Conclusion

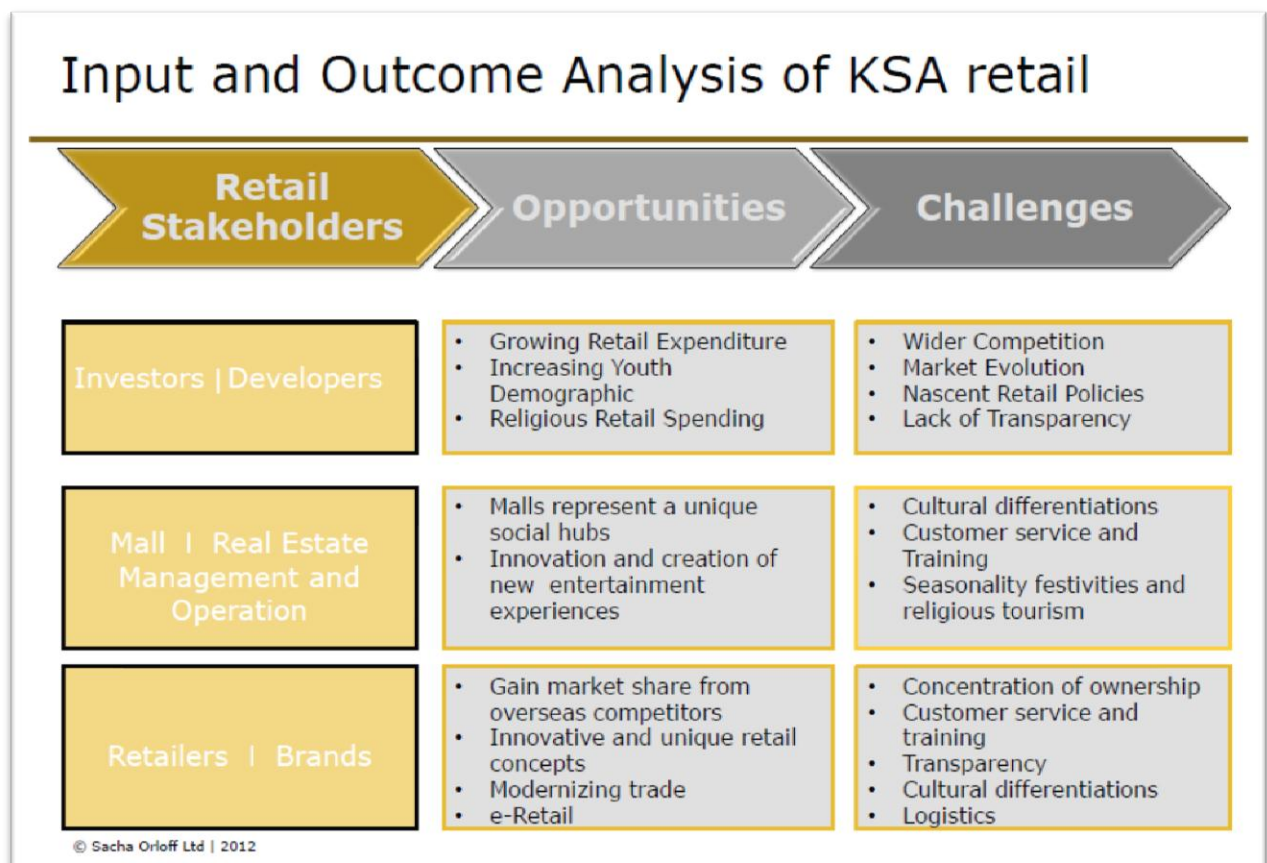
5.1 Input and outcome analysis of KSA retail

It is obvious that the Saudi Retail landscape is changing, malls and urban areas are becoming more developed to the latest architectural standards. In Saudi Arabia there is a will to be different from any other Middle Eastern cities, where no comparison can be made to its neighbour in the UAE. The plan is to acquire a maximum of market shares from its citizen to shop at home, added to the multitude of religious tourism which influences the Saudi retail economy.

Mall owners and its management do understand the importance of re-structuration, innovation and diversification. With these strategic elements the outcome will be a higher financial share. The actual challenge is the Saudization with thorough policies to train its workforce to the highest standards and the pride to be unique with its own cultural consideration.

Family businesses which are diversifying into retail have the means and the will to adjust to the worldwide standards, time is needed to put in place the existing retail policies and best practices. The investment and commitment to training will have to be seen as a true asset in their workforce retention.

A large portion of the population in the Middle East and in Saudi Arabia will use even more internet to study, explore and shop. This market is still at its infancy in the region, therefore retailers should focus their effort on this newer e-retail segmentation, using as well all social media tools to gain financial results. Most of all, major retailers should not wait to launch their ecommerce websites this year, and not wait for their competitors to take the lead.



SACHA ORLOFF GROUP

Suite 534 | 28 Old Brompton Road| SW7 3SS | London| United Kingdom

UK Tel: +44 2077328808

UK Mob: +44 7971177772

UAE Mob: +971 566124972

Web: www.sachaorloffgroup.com

Blog: <http://sachaorloff.wordpress.com>

Twitter: @SACHAORLOFF

For questions and inquires about the Saudi Arabia retail market, please contact:

Alexandra de Kerros Boudkov Orloff

CEO

Email : alexandra@sachaorloffgroup.com

Author: Alexandra de Kerros Boudkov Orloff

