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A warning to would-be retail entrants: adapt or die

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Foreign retailers need to upgrade their management to stand firm in the Chinese market. This year the British home improvement retail chain B&Q was forced to beat a retreat after it was asked to close its store in Qingdao, Shandong province, because it failed to comply with sanitation regulations. Another store in Nanjing, Jiangsu province, was shut down.

B&Q is not the only foreign retail chain with woes in China. Many others in a range of industries are mired in problems. Apart from the sluggish property market, escalating conflicts between retailers and suppliers and the rise of competitive local retailers, many other things are conspiring to make it difficult for foreign retailers in China to grab market share.

But at the root of it all the biggest failing of these businesses is this: they have failed to localize properly. If they wish to gain a firm foothold in China, they need to explore a new way of management that takes local conditions into account.

With a continuously shrinking market, B&Q has suffered big losses in China. It entered the Chinese market in 1999, made a profit from 2003 and reached its peak from 2005 to 2007. It opened 63 stores across the country, and annual sales reached 313 million pounds ($490 million, 374 million euros). From 2008 things started going downhill and B&Q closed many stores and suffered losses for four straight years.

The foreign retail chains with problems in China include electrical appliances and food. Last year Best Buy, the largest electrical goods retailer in the US, shut down its nine stores on the mainland and its headquarters in Shanghai after five years in China. And E. Mart, the largest supermarket in South Korea, jettisoned 10 stores at cut-rate prices, accounting for 40 percent of its Chinese stores.

So why is it all proving so difficult for these foreign retailers in China? The sluggish property market has reduced the demand in home construction and home decor markets. The strict regulation of the property market has slowed housing sales and led to shrinking demand of building materials.

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In the West, most consumers step into the home construction market to renovate their homes, whereas most Chinese consumers buy building materials to decorate new homes.

On the other hand, retailers are losing support from their suppliers. B&Q, for example, charges its suppliers large sums for various services: display and promotion, installation, consultation, ads and sales. What's more, the sales commission percentage has risen year after year. All this has piled pressure on suppliers, who were having to pay sales commission higher than the stable 15-17 percent other stores in the industry ask for.

In June 2007 B&Q fell behind with its payments to one of its suppliers, YOE Shanghai. YOE, Hanex and many other suppliers announced that they would stop doing business with B&Q.

The conflicts between retailers and suppliers also tarnish retailers' reputation. At the end of 2010, because of dissatisfaction with Carrefour's sign-on fee, the Chinese food giant COFCO, the instant-noodle giant Master Kong and another oil company, Sanjiu, jointly cut their supplies to Carrefour, and the French chain's image in China took a battering.

Foreign retailers now have to face competitive local retailers. Local home retailers such as Macalline and Easyhome employ a new business model that provides a platform to suppliers, allowing them to run their own booths in the retailers' stores. This business model offers better product display and shopping experience and more direct services in the whole process of purchase. In contrast, B&Q has obvious defects in its shopping experience, and its standardized goods displays are thought to have weakened suppliers' brands.

B&Q's prices are not that competitive compared with those of local retailers who provide booths to suppliers in their stores. The latter allows consumers to bargain with suppliers since it is the suppliers who decide what the prices should be. B&Q does not provide such convenience to shoppers and suppliers.

In management pattern and cost structure, local retail chains have the upper hand. Best Buy purchases goods from suppliers and then hires its own sales people, resulting in high costs. Local retail chains such as Gome and Suning partly rely on salesmen employed by suppliers.

Foreign retailers' localization is insufficient. Foreign home building material chains mainly promote the DIY concept, but Chinese consumers prefer to leave building materials to decorating workers. Foreign brands always have consistent product lines without frequent changes while local brands provide a variety of products within a short time. So B&Q's business model does not suit suppliers who want to show their products flexibly to shoppers. Such suppliers like the idea of booths being provided in chain stores.

Relying on its own sales people, Best Buy can offer more efficient after-sales service and a high-end shopping aura. But the management pattern featuring professional service does not suit the Chinese market yet. Because the main preoccupation of Chinese consumers is price, they usually look at products on the shelves of Best Buy and then buy them through other channels at lower prices.

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Retail in China has left the realms of extensive management and ushered in a new phase of full competitiveness. Without the privilege and protection of local governments, foreign retailers without enough localization inevitably face challenges, which can mean closing money-losing stores.

Local retailers in China have become mature and have been on the road to rapid development. Many have surpassed their foreign counterparts such as Wal-Mart and Carrefour in local market share and management. China Resource Vanguard Co in Shenzhen, Yonghui supermarket in Fujian province are examples.

To win a stable market in China, foreign electrical appliance chains should explore a new management pattern that suits the Chinese market. Foreign home improvement retailers should dig deep to harness their potential, do things they are good at and work with other companies to tap the Chinese market. For example, the electrical goods retailer Media Markt chose to work with Foxconn to enter the Chinese market. With the help of Foxconn's mature distribution networks and cheap products, it avoided the fate of Best Buy and opened three more new stores in Shanghai at the end of last year. Taking advantage of the warehouse display style of its parent company Metro, Media Markt can maximize its product display.

If possible, foreign home improvement retailers can try the business model of the local electrical appliances giant Gome - buying land, building houses, designing and decorating stores and then renting booths in their stores to suppliers. This kind of business model will draw on the advantages of both foreign retailers and big-brand suppliers to attract consumers. Besides, foreign enterprises will be able to draw stable profits from property appreciation and large-scale housing rentals.

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