S w

**909A16**

#  BEST BUY INC.- DUAL BRANDING IN CHINA

*R. Chandrasekhar wrote this case under the supervision of Professor Niraj Dawar solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.*

*Ivey Management Services prohibits any form of reproduction, storage or transmittal without its written permission. Reproduction of this material is not covered under authorization by any reproduction rights organization. To order copies or request permission to reproduce materials, contact Ivey Publishing, Ivey Management Services, c/o Richard Ivey School of Business, The University of Western Ontario, London, Ontario, Canada, N6A 3K7; phone (519) 661-3208; fax (519) 661-3882; e-mail cases@ivey.uwo.ca.*

*Copyright © 2009, Ivey Management Services* *Version: (A) 2010-05-11*

In June 2006, John Noble, senior vice president at Best Buy International, a division of Best Buy Inc. (Best Buy), the largest retailer of consumer electronics (CE) in the United States, faced a major strategic branding decision. Earlier that month, the company had acquired a majority stake in Jiangsu Five Star Appliances (Five Star), the third-largest retailer of appliances and consumer electronics in China. Noble had been assigned to the international division just a month earlier from the company’s Canadian operations, where he had held a similar position since 2002. In his new role, Noble was tasked to decide and plan how Best Buy should implement a dual-brand strategy in China. The dual-brand strategy adopted in Canada four years earlier seemed to have worked well. “Will the dual-brand strategy work in China?” he wondered. “How should I make it work?”

While negotiating for a majority stake in Five Star, which had 135 stores in China, Best Buy announced plans to open its first Best Buy store in China in December 2006, to be followed by two more stores in the next 12 to 18 months. Five Star also announced its own agenda of opening 25 additional stores in China, under the Five Star banner, during approximately the same period.

**CONTEXT**

When Best Buy decided to go beyond the domestic market in the United States in December 2000, the company had found neighboring Canada to be a logical first step. The Canadian CE market was fragmented, with only one dominant player, Future Shop. Best Buy’s original objective was to set up its own stores in various Canadian cities to compete directly with Future Shop stores. It had planned to open the first of several stores in the Toronto area in 2003, and then embark on a three-year expansion program that would see the launch of 15 stores in major Canadian cities. Best Buy had a target of setting up 60 to 65 stores across Canada, competing with the 95 stores of Future Shop, which itself was planning to increase its stores to 120 over four years. As part of a defense strategy, Future Shop was also finalizing plans to relocate or renovate at least half of its existing stores by 2005.

In August 2001, the founders of the two companies met and decided, over the course of three weeks, that “together we could accomplish infinitely more than if we were to go our own ways and compete with each other.”[[1]](#footnote-2) By January 2002, Best Buy had acquired 100 per cent ownership in Future Shop. Then, when the time came to finalize integration, the management of Best Buy took a surprising decision: to retain the Future Shop brand and let it compete with Best Buy as an independent brand, a strategy that had no precedent within the company. The dual-brand strategy — wherein two brands, both part of a common corporate entity, vied for market share — was an initiative being tested for the first time at Best Buy (see Exhibit 1).

In reference to whether the dual brand strategy could be implemented, Richard Schulze, the founder of Best Buy, was famously quoted for saying, at the time of the acquisition, “I’m not saying it can’t be done, I’m saying it’s never been done before . . . .”

**BEST BUY**

Headquartered in Minneapolis in the United States, Best Buy was driven by a vision of “meeting consumers at the intersection of technology and life.”[[2]](#footnote-3) The company saw its core strategy as “bringing technology and consumers together in a retail environment that focuses on educating consumers on the features and benefits of technology and entertainment while maximizing overall profitability.”[[3]](#footnote-4) Best Buy was positioned to deliver new technologies at the retail level in the three segments of devices, connections and content, enabling the company to capitalize on the progressive digitization of analog products and the accelerating digital product cycles to mobilize consumer demand. The company was selling its products at moderate to upper moderate price points.

Growing at a rate of between 15 per cent and 20 per cent every year, Best Buy had attained sales revenues of US$30.9 billion for the year ending March 2006 (see Exhibit 2). The company had more than 20 per cent share of the retail American consumer electronics market, which was valued at US$152 billion in 2006.4 Globally, the CE market was averaging a growth rate of 10 per cent and was expected, according to CEA/GfK Worldwide Consumer Electronics Sales & Forecast, to reach revenues of US$700 billion by 2009.[[4]](#footnote-5) In planning to maintain double-digit growth rate year after year, Best Buy saw, in its international expansion, a window of opportunity.

**History**

Best Buy was founded in 1966, by Richard Schulze, an American entrepreneur from the mid-west. The chain, which was known at the time as Sound of Music, was retailing audio components sourced from vendors. The company struggled through the recession years of the 1970s, and with the arrival of the video cassette recorder in the early 1980s, the music chain expanded into retailing video components. In 1983, Sound of Music moved into mass merchandising by switching to a superstore format (characterized by a wide range of products and boxes of merchandise in a warehouse atmosphere) under the new, distinctive yellow Best Buy banner. Six years later, Best Buy refined its retailing techniques in three ways: the introduction of self-service, the placement of its salespersons (referred to as “Blue Shirts”) on fixed pay instead of on commission and reconfiguration of stores’ formats to a discount style. The changes were made in recognition of both a trend in customers of being knowledgeable enough to choose products on their own and their preference of shopping in a consumer-friendly environment.

**Innovations**

The company’s decision to stop paying commissions to salespersons and put them on salary did not go well initially with vendors such as Toshiba and Hitachi. These manufacturers had long felt that a highpressure, incentives-oriented and results-driven approach at the store was necessary to move products. But Best Buy soon realized that its customers were comfortable in the new, informal ambience at its stores.

After entering new domestic markets, such as Chicago, Philadelphia and Boston, Best Buy became the biggest seller of home personal computers (PCs) in 1995, in time for the Internet boom. In 1996, Best Buy surpassed Circuit City to become the top CE retailer in the United States, a position that Best Buy had since held.

Best Buy had spotted another trend. Digital devices and home networks were growing in complexity, opening up a prospect for marketing the necessary technical services to homes and small businesses. This opportunity was pegged at being worth more than US$20 billion a year in the United States. Best Buy had acquired, in October 2002, a Minneapolis-based startup specializing in repairing and installing PCs, called Geek Squad. Within a year, Best Buy had Geek Squad precincts, staffed by newly recruited techies, in more than 20 stores. By 2005, the geeks had set up shop in all Best Buy stores. The move was an advantage over competitors, such as Wal-Mart, which did not provide service back-up for their CE sales.

**Centricity**

Best Buy had identified the technology enthusiast as its core customer. This target group was characterized by the following attributes: aged 15 to 39, male, highly educated, above-average income and eager for products and services that would render personal time both productive and enjoyable, and resonate with being fun, honest, young and techno-savvy. Best Buy was building its brand promise on those very lines: “being fun, honest, young and techno-savvy.”

In the late 1990s, Best Buy established a standard operating platform (SOP) for replication across the chain, which included procedures for inventory management, transaction processing, customer relations, store administration, products sales and merchandising. SOP had a harmonizing effect on the company, helping ensure consistency and enforcing discipline across the network of stores. Best Buy was now a process-driven organization with systems and procedures firmly in place. By early 2000, however, Best Buy was evolving from being an organization thriving on standardization to one offering, within a standard format, different value propositions appealing to different groups of customers. Thus, the company began in 2001 to test and implement a concept it called centricity.

The concept was based on four elements:

1. Identifying customers generating the most revenue
2. Segmenting these customers
3. Realigning the stores to meet the needs of these customers
4. Empowering the store sales staff, known as Blue Shirts, to steer these customers toward products and services that would encourage them to visit more often and spend more on each visit

The company’s market researchers combed through reams of sales and demographic data to determine whether a particular location should be tailored to, say, empty nesters or small business owners. A store located in a geographical area characterized by a higher density of homemakers would, for example, include features such as personal shopping assistants (PSAs) who were chosen from among Blue Shirts to help a shopper with such tasks as selecting the right digital camera for her family. Blue Shirts were schooled in financial metrics, such as return on capital, so that they could ascertain for themselves the effectiveness of merchandising.

Centricity was a big investment in terms of enhancing end user experience. The company examined, in detail, everything from store fixtures and layout to the product–employee mix and staff training. Recasting a store toward affluent tech-enthusiasts would cost approximately US$600,000 alone for lighting and fixtures. The concept of centricity, which was built essentially on customer insights, was also meant to encourage employee innovations in support of a better customer experience, not just at a single moment in time but on a continuous basis. The goal was to drive customer engagement and foster repeat visits.

**Store Operations**

At headquarters in Minneapolis, Best Buy store operations were organized into three divisions. Each division was divided into regions under the supervision of a senior vice president overseeing store performance through regional managers who were with responsibility for a number of districts within the region. The district managers monitored store operations closely. Each district also had a loss prevention manager, and product security personnel employed at each store controlled inventory shrinkage. Best Buy controlled advertising, pricing and inventory policies from corporate headquarters.

**Competitors**

The CE retail market in the United States was competitive at four levels. The major competitors were mass merchandisers (e.g. Wal-Mart and Costco). These competitors were regularly increasing their portfolio of CE products, particularly of those products less complex to sell, install and operate. Contemporary channels of distribution (such as Internet shopping, facilitated by e-commerce platforms set up by some manufacturers themselves) were the second source of competition. Also competing in the CE market and gaining market share were factory-direct shopping services (e.g. Dell Computers). Finally, home improvement retailers (e.g. Home Depot and Lowe’s) were also entering into the consumer electronic product market. Lines were blurring as retailers of all kinds were widening their product assortments in pursuit of revenues and margins.

**DUAL BRANDING IN CANADA**

Best Buy paid Cdn$560.71 million (US$363.95 million) to acquire Future Shop, based on the offering price of Cdn$17 per share, a 47.8 per cent premium over the market price of Cdn$11.50 per share. However, a little over a year after deciding to expand internationally, Best Buy experimented with a concept that was novel in the CE market worldwide. Said Noble:

There were four reasons why Best Buy veered towards a dual-branding strategy in Canada. First, the Canadian CE market was fragmented with the leader, Future Shop, having only about 15 per cent share. We felt there was room for a second brand. Given that most retail sectors in the US had at least two major players — for example, Home Depot/Lowe’s and Staples/Office Depot — we felt that a second major retailer in CE in Canada would be in order. Second, Best Buy had already signed, before perceiving Future Shop as a potential target for acquisition, about eight real estate leases as part of its original greenfield approach. Some of these leased spaces (as in the Heartland location at Mississauga, a suburb of Toronto) were situated right next to Future Shop stores for planned head-to-head competition. We were committed to those locations. Third, there were operational factors. Conversion of Future Shop stores into Best Buy stores would take a while, particularly in terms of store redesigns and staff transition. Not all the elements of Best Buy’s SOP could simply be set up “as is” in Canada. There would be a period of time when the two brands had to be managed independently. As it turned out, it gave us a window through which to look at issues differently. But, the most important reason was the recognition that Future Shop was a well established brand, with over 95 per cent unaided brand awareness among Canadians. Replacing such a hugely successful brand with Best Buy, which was unknown in Canada, seemed counter-intuitive.

Best Buy also had other reasons for pursuing a dual-brand strategy. If the senior staff at Future Shop were focused on setting up the Best Buy operation, their activities risked affecting negatively on the existing sales of Future Shop stores. Putting together a separate team at Best Buy, fully dedicated to opening the greenfield stores of Best Buy, as originally planned, would speed up the process of the company’s market entry.

But the dual-brand strategy also had some downsides. Said Noble:

We had four concerns about the dual-branding strategy. Cannibalization was, of course, a major issue. It was likely that each Best Buy store would eat into the earnings of a Future Shop store and vice versa, particularly when the two were in close proximity. Since the company would have to manage two different brands, the marketing dollars in Canada would be split in half, minimizing the impact of ad-spend. Also imminent was the possibility of a blurring of brand identity in the eyes of the consumer. Finally, there would be duplication of roles at the corporate headquarters at Minneapolis, with the two brands requiring separate staff inputs.

The two brands were each headed by a vice president based in Vancouver, the location of Best Buy Canada Ltd. (BBYC), the newly formed subsidiary that maintained the two brands. BBYC took several steps to reinforce the operations of both brands at ground level: opening an automated 450,000-square-foot distribution center in Ontario and, eventually, another 500,000-square-foot distribution center in British Columbia, to support store growth for both brands; outsourcing a call center to provide 24-hour service, seven days a week; and retaining a premier insurance company to underwrite product warranties. Stores of both brands were open 60 to 75 hours per week, seven days a week. All stores used the parent company’s SOP.

An average Future Shop store was staffed by a general manager, an operations manager, one to four department managers and 48 to 95 sales associates, as well as part-time sales associates. An average Canada Best Buy store was staffed by a general manager; assistant managers for operations, merchandising, inventory and sales; and 80 to 110 sales associates, including full-time and part-time sales associates.

Although Best Buy and Future Shop effectively competed for market share, the positioning for each company was different. Best Buy, with its yellow-price-tag logo continued to offer the “grab and go” option by providing an open floor plan that allowed customers to shop on their own or with the help of a no-pressure (i.e. non-commissioned) Blue Shirt product specialist if desired. Future Shop focused on offering the trusted, personalized customer service for which it was already well known in Canadian cities.

By the end of the first year of operations, there were indications that the dual-branding strategy was working in Canada. For example, the Future Shop store at Mississauga had sales revenues of $40 million in 2001/02. In 2002/03, post-acquisition, revenues were $38 million. Cannibalization was minimal because the Best Buy store, located across the street, had delivered an additional $30 million in sales for the same period. Overall, Best Buy had achieved a combined market share in Canada of 34 per cent. In some places, the proximity of the two banners had created a shopping destination. The company’s research also pointed out that the customer bases of Best Buy and Future Shop were different. Canadian customers viewed the two brands as distinct, not interchangeable. One indication was that only 18 per cent of customers applying for a Best Buy credit card in fiscal 2004 already held a Future Shop credit card (see Exhibit 3).

The board of Best Buy was now willing to support the dual-brand strategy in Canada as long as Best Buy entered new markets in Canada and delivered on sales targets, while Future Shop continued to deliver on its own sales targets. In negotiating with Five Star in China, the board was willing to support a similar strategy on similar expectations (see Exhibit 4).

**ENTERING CHINA**

A country of 1.3 billion consumers, China had been attracting the attention of overseas investors since it began liberalizing the economy in 1985. Over the next two decades, its manufacturing side boomed, with the growth in gross domestic product (GDP) averaging 10 per cent per annum. The consumption side, however, was growing at a pace slower than output and not catching up. Consumption as a percentage of GDP had in fact dropped from 47 per cent in 1995 to 37 per cent in 2005.[[5]](#footnote-6) A process of adjustment was under way, and because the Chinese economy was moving from the historical investment-led growth model to a consumption-led growth model, many multinational marketers were beginning to see an opportunity. McKinsey Global Institute had predicted that China would become the third-largest consumer market in the world by 2025 (see Exhibit 5).

Best Buy’s original interest in China had been flagged by China’s manufacturing base. Since the 1990s, the China had become a major hub in the Asian region for the manufacture of CE components. In a little more than a decade, China was playing host to a number of manufacturers from the United States and Europe. Attracted by the country’s low labor costs, these manufacturers had started relocating their domestic manufacturing operations to China. A fast-growing home market was also spurring China’s CE manufacturing industry. According to Instat, an American high-tech market research firm with an office in China, the manufacturing end of the CE industry in China, which was estimated at $71.5 billion in 2006, was expected to more than double by 2010.[[6]](#footnote-7)

In September 2003, Best Buy opened a 25-person sourcing office in Shanghai, China. This move complemented the company’s plans to expand its existing 450 stores in the United States and 127 stores in Canada to at least 1,200 stores in North America over the long haul. The Shanghai office was seen as a means of both lowering the cost of goods sold and driving gross profit rates on individual products. This office was also meant to fill the gaps in the company’s product assortment with private labels from the Asian region. Said Noble:

China was chosen as the second international expansion market primarily due to the overall market opportunity, consumer fundamentals and macro-economic factors. We did look at other markets such as Europe, especially France and Germany, but, they were mature, competitive and offered less quality retail real estate at a high cost.[[7]](#footnote-8)

The Chinese CE retail market was fragmented. The top five players together held less than 20 per cent of the market share. However, the Chinese market was expected to account for 25 per cent of the global CE market by 2010. Taking a slice of the new growth opportunity ranked high on the agendas of multinational corporations. Best Buy was the first, and so far the only, multinational to have entered the retail end of Chinese CE market.

China’s CE retail market was, however, a complex terrain to navigate for a new entrant. Price wars were rampant. In categories such as TVs and white goods, excess capacity had squeezed profit margins to less than three per cent, the lowest in the world. Although consolidation among electronics retailers had been ongoing, a new wave of mergers and acquisitions (M&As) was evident within a space of a few months in early 2006. Gome Electrical Appliances Holdings Ltd. (Gome), China’s leading electronics specialty chain, had already mounted a bid on China Paradise Electronics Retail Ltd. (China Paradise), which itself had struck — and then put on hold — an alliance with the privately owned Dazhong Electrical Appliance Co. Ltd., the fifth-largest CE retailer in China The formalities pertaining to acquisition of China Paradise by Gome were to reach closure in late July 2006. Best Buy had already acquired Jiangsu Five Star in April 2006.

The Chinese CE market had some unique characteristics. For example, approximately two-thirds of the sales staff in a retail store were on the payroll of suppliers. Also, the rate of growth of “other income” was often higher than the rate of growth in sales. The gross margin of Chinese retailers was understated without taking into account “other income,” which included rebates and listing fees, often the equivalent of a retailer’s gross profit. Instead of a mark-up on the cost of goods sold, the retailers received rebates.[[8]](#footnote-9)

**Buyer Behavior**

In 2004, approximately 36 million urban Chinese households had a disposable income of at least RMB25,000 (approximately US$3,000) a year, which was considered, by local standards, a reasonable threshold for entering the consumer class. By 2009, the number was expected to almost triple, to 105 million urban households. A massive influx of new consumers was now reaching the retail cash registers. Every year, approximately 20 million Chinese (the population of Australia) turned 18 years of age.

Prosperity was lifting the incomes of tens of millions more.[[9]](#footnote-10)

Chinese consumers were not prone to opening their wallets freely. The savings rate in China in 2006 was 28 per cent of monthly household income, compared with three per cent in the United Kingdom and two per cent in Canada. Chinese consumers were also not accustomed to the concept of credit. The credit card penetration rate in urban households was less than four per cent, compared with 75 per cent in the United States, 78 per cent in Japan and 91 per cent in Germany. Less than six per cent of credit card holders in China carried forward their ongoing balances.[[10]](#footnote-11)

Observers had found that Chinese consumers responded better to messages focusing on functional features than those focusing on brand imagery. At one level, Chinese consumers were attracted to brand names but, on another level, they were wary of premium prices. Brand preferences of customers did not always translate into revenues in the form of increased market share for companies. Salespersons held sway over the buying decisions of consumers who were also influenced by point-of-sale promotions to make lastminute switches. Because Chinese consumers had a sense of national pride, a multinational corporation, by seeming foreign, could lose potential customer segments.[[11]](#footnote-12)

**Growth Centers**

In markets such as the United States and Canada, consumers exhibited few differences between regions, which required companies to make choices only between products and segments. In China, the trade-offs had an additional dimension, requiring product-segment-region choices. Marketers had to factor in regional differences because as one moved across tiers of cities in China, a steep drop-off was experienced in infrastructure, channels and disposable income. When a mass merchandiser entered China, it evaluated the country’s cities, giving each locale a tier designation on the basis of size, sophistication, purchasing habits, attitudes and disposable income of its population and its own product offerings.[[12]](#footnote-13) A typical classification is shown in Exhibit 6.

A massive increase in retail space was evidence of increasing competition in China’s tier-one cities in particular. Major players were eyeing growth opportunities in tier-two and tier-three cities. The attendant risk was the longer breakeven point because, given the much lower income levels in those cities, sales would be slower. However, the costs of retail space would be lower, and given less competition, margins were likely to be higher.

China also had other limitations. Land acquisition in cities was often difficult; procedural delays meant that a new entrant would take at least six months to open a store; relationships between vendors and retailers were so close and guarded by local customs and preferences, that an outsider did not have an easy time getting a foot in the door. Manufacturers of CE were not likely to cut a new entrant such as Best Buy much slack on pricing, particularly because personal relationships (referred to as “guanxi” in local terminology) influenced the conduct of business among Chinese who were more comfortable dealing with people they knew. China was also experiencing a crunch of quality human resources because retailing, as an industry, had not yet developed in the country.

**MAJOR COMPETITORS**

Before being acquired by Best Buy, Five Star had two major competitors, Gome Electrical Appliances Holdings Ltd. (Gome) and Suning, both publicly held (see Exhibit 7). Together, the two companies had saturated many of the country’s largest cities over the past few years. Although the total market shares in 2005 of the top five in 2005 (comprising Gome, Suning, Five Star and two others) accounted for less than 20 per cent of market share, Gome and Suning held a combined market share of 70 per cent in some appliance product categories, such as air conditioners.

**Gome Group**

The Gome Group had two companies: Gome Electrical Appliances Holdings Ltd. and Beijing Gome (an unlisted company). In 1993, Gome opened its first store in Beijing, and soon expanded into other major cities in China, gaining widespread consumer acceptance. By mid-2005, the group had 437 stores (of which 263 belonged to the listed company) in 132 cities in China, with the most extensive distribution network of all the home appliance retailers in China. It was leading in all regional markets (Northeast China, North China, Northwest China, South West China and South China) with the exception of East China, the home market of Suning, where Gome was ranked number three.[[13]](#footnote-14)Gome was the largest CE retailer in China with six per cent market share, prior to its acquisition of China Paradise. The company was mounting a bid on China Paradise, likely to come through in a few weeks, for a record sum of $677 million.[[14]](#footnote-15)

At the beginning of 2005, Gome had announced its four-year growth initiative aimed at enlarging its geographical coverage and raising its national market share to 10 to 15 per cent by the end of 2008. Although Gome had set itself apart, to start with, on a super-store format offering the lowest prices, the differentiation had been subsequently commoditized in by its competitors. Gome had then cracked the traditional business model (of selling through intermediaries to various retail formats) by dealing directly with mega brands. In introducing category killers, the company had set a new trend in CE retailing in China. The company had also begun to focus on pre-sales service, as opposed to the industry practice of after-sales service, by advising customers on which brands to choose. Because this service was not easy to implement at the store level, where brands had their own commission-based sales staff, Gome was examining a new store format it called Eagle (Gome had been known earlier as China Eagle). Gome opened its first Eagle store in December 2005, in Shenyang. This mega-store, which occupied 15,000 square meters differed in two ways: all sales staff at Eagle were on the payroll of Gome; and the display format was based on categories not brands. The company was planning to open six to nine Eagle stores in the next three years, depending upon how the performance of the first two.

The group was planning to expand rapidly into tier-two cities in particular, not only because of improvements in economies of scale and customer acquisition but also because, as a first mover, it could secure preferential tax treatments from local governments welcoming jobs creation opportunities. It was unlikely that the second or third movers would be entitled to the benefits offered to the first mover.[[15]](#footnote-16)

**Suning**

Suning had grown from a regional air-conditioning retailer to a leading CE retail chain in China in less than a decade. It was in the process of converting its stores into a customer-oriented format it called 3C (computers, communications and consumer electronics). The company was on an expansion spree, increasing its stores five fold in the last three years to 224, with more than half of them opening in 2005 alone, covering 61 cities.It was now planning to double the number of stores in two years. By the end of 2006, only 25 per cent of Suning’s retail space would have been opened for two years or more. In common with Gome, which also had a high proportion of new retail space, rapid store expansion and entry into less affluent tier-two cities had led to lower productivity of retail space at Suning.[[16]](#footnote-17)

Suning operated three types of stores that shared the same format: flagship, central and community. The stores differed in size and product assortment. Flagship stores were found in large cities or regional headquarters. These stores were the largest in size and sold a wide variety of products. The central stores were most common. All the stores were CE retail stores targeting the mass market.

Suning sought differentiation in two ways. It was aligning its product assortment to address the needs of what it called “3C”customer groups (computers, communications and consumer electronics). It was also using service as its key competitive advantage. The company had set up 15 regional distribution centers, 30 customer service centers and 500 service stations of its own to reinforce the message that service was its main product.

**FIVE STAR**

Five Star was China’s third-largest electronics and appliances chain. It had 135 stores located mostly in the fast-growing, second-tier cities, in eight of China’s 34 provinces. Founded in 1998 and headquartered in Nanjing in Jiangsu province, it had revenues of US$700 million in 2005, a 50 per cent increase over 2004. The company’s founder Wang Jianguo wanted to expand internationally but was constrained by delays in official permissions for listing his company abroad. “Our scale was becoming a bottleneck to development,” he said.[[17]](#footnote-18) When Best Buy sounded the idea of making an investment in the company, he decided to cash out and offload 75 per cent stake in the company to Best Buy for $180 million. Five Star employed more than 12,000 of its own employees (see Exhibit 8).

**ISSUES IN JUNE 2006**

In examining the prospects of dual-branding strategy in China, Noble had to make a call on whether it would serve as well in China as it did in Canada. He had to define the road map for implementing the strategy in China. In a broader context, he also had to explore the possibility of developing dual branding into Best Buy’s main competence over time. Best Buy was now at a stage at which the learning it had gained from international expansion, initiated in 2002, could be used to accelerate the company’s transformation in the U.S. domestic market, which it considered its core market. In his new role at Best Buy International, Noble was regularly tracking and evaluating global opportunities, looking for growing economies with buoyant consumer demand. Turkey and Mexico were potential targets for international expansion.

Customer centricity was a home-grown competence that Best Buy had deployed in Canada, and that seemed to have a universal appeal, applicable to any new market. SOP, which the company owned, was another. Geek Squad, a company innovation, seemed to be equally pervasive. Noble wondered whether a dual-branding strategy, which had been executed in Canada, could be as readily implemented in the international markets of the future. Was there a template of dual-branding that could be deployed, with a minor tweaking where necessary, to any new market, he wondered. What would that template be?

## Exhibit 1

**BEST BUY AND FUTURE SHOP IN 2002**

|  |  |  |
| --- | --- | --- |
|  | **Best Buy**  | **Future Shop**  |
| Typical store size  | 35,000 square feet  | 26,000 square feet  |
| Store associates  | Blue Shirts  | Product Experts  |
| Staff mandate  | Technology is fun. We make it easy for the customer  | Providing Trusted Personalized Service  |
| Customers  | Tech enthusiasts who enjoy the interactive shopping experience and grab-and-go convenience  | Tech savvy; a notch higher than the Best Buy customer; at the cutting edge of developments in technology  |
| Aisles  | Wide aisles to provide for grab-andgo shopping  | Highlights key technologies first  |
| Service  | Upon request  | Attentive  |
| Sales  | Customer led No high-pressure salesmanship  | Sales-person led Commission-based sales  |
| Target group  | Higher success rate with female customers  | Male-oriented  |
| Customer profile  | 15 to 39 years  | 25 to 44 years  |
| Brand identity  | “Turn on the fun”  | “The place to get it first”  |
| In-store experience  | Relaxed  | Guided  |
| Product mix  | Although by category the two store brands were very similar, each was able to offer a unique selection of products and brands. Product brands and depth of selection differed within product categories. On average, 45 per cent overlap of the product assortment (excluding entertainment software) between the two store brands.  |
| Areas of distinction  | Higher propensity towards selfservice; non-commissioned sales staff; greater assortment of readymade electronics packages; wider aisles and more interactive displays; higher ratio of female customers, seeking to integrate products into their lifestyles; customers with higher incomes and higher levels of education  | Commissioned sales staff guiding the customer by providing customized, trusted and personalized approach; tech savvy, early adopters looking for the best deal; customer base more diverse  |

*Source: Company files*

## Exhibit 2

**BEST BUY INC – INCOME STATEMENT**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Year ending March (in US$million)  | 2006  | 2005  | 2004  | 2003  | 2002  | 2001  | 2000  | 1999  |
| **Revenue** Domestic International Total Less: Cost of goods sold Gross profit Less: S&G expenses Operating income Net interest income Earnings before tax Income tax Other (Loss)/Gain Net earnings  | 27,380 3,468 **30,848** 23,122 7,726 6,082 1,644 77 1,721 581 – 1,140  | 24,616 2,817 **27,433**20,938 6,495 5,053 1,442 1 1,443 509 50 984 | 22,225 2,323 **24,548**18,677 5,871 4,567 1,304 (8) 1,296 496 (95) 705 | 20,946 – **20,946**15,710 5,236 4,226 1,010 4 1,014 392 (523) 99 | 17,711 – **17,711**13,941 3,770 2,862 908 18 926 356 – 570 | 15,326 – 15,326 12,267 3,059 2,455 604 37 641 245 – 396  | 12,494 – **12,494**10,100 2,394 1,854 539 23 562 215 – 347 | 10,064 – **10,064**8,250 1,814 1,463 351 1 352 136 – 216 |
| **Category wise revenue****Domestic** * Home Office

-Video & Audio * Ent. Software
* Appliances

**Internationa**l * Home Office
* Video & Audio
* Ent. Software
* Appliances
 | 8,762 11,773 5,202 1,643 1,526 1,318 487 139  | 8,380 9,609 5,169 1,476 1,127 1,155 422 113 | 7,556 8,445 4,889 1,335 929 930 348 116 | – – – – – – – – | – – – – – – – – |  |  |  |
| **Number of employees** (in 000s) | 128 |  |  |  |  |  |  |  |
| **Cash and equivalents** (in US$million) | 681  | 354 | 245 |  |  |  |  |  |

*Source: Best Buy annual report.*

## Exhibit 3

**BEST BUY AND FUTURE SHOP — PERFORMANCE METRICS 2000 AND 2006**

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | **2000**  | **2006**  |
| Metric  |  | Best Buy (in US)  | Future Shop  | Best Buy (in Canada)  | Future Shop  |
| Sales growth Gross margin SG&A expense ratio Operating margin Sales per square foot Inventory turn Operating ROA  |  |  21.4%  20.2% 16.2% 4.0%  $870  7.5  18.7%  |  17.0% 22.7% 20.1% 2.6%  $746  7.4  12.77%  |  34.3% 24.2% 17.8% 6.4%  $1,010  6.4 n/a  |  14.2% 24.8% 16.7% 8.1%  $1,069  6.4 n/a  |

*Note: SG&A = selling, general and administrative; ROA = return on assets; n/a = not applicable Source: Deutsche Banc Alex. Brown estimates for 2000 data, Company records for 2006 data.*

## Exhibit 4

**BEST BUY —NUMBER OF INTERNATIONAL STORES 2006**

|  |  |  |
| --- | --- | --- |
| **Province/State**  | **Canada**  | **China**  |
| Best Buy stores  | Future Shop stores  | Best Buy stores  | Five Star stores  |
| Alberta British Columbia Manitoba New Brunswick Newfoundland Nova Scotia Ontario Prince Edward Quebec Saskatchewan Anhui Henan Jiangsu Shandong Shanghai Sichuan Yunnan Zhejiang  |  7  7  2  –  –  1  25  –  8 1 |  15  21  5  3  1  3  55  1  24  3 | – – – – 1 – – –  |  12  9  99  9  –  6  4  21  |
| Total  |  51  |  131  | 1  |  160  |

*Source: Best Buy 2008 annual report.*

**Exhibit 5**

## CHINA’S ECONOMY, 2003–2005

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Unit  | 2005  | 2004  | 2003  |
| Gross National Income Gross Domestic Product Per capita Gross Domestic Product  | 100 million Yuan 100 million Yuan Yuan per person  | 183,956.1 183,084.8 14,040.0 | 159,586.7 159,878.3 12,336.0  | 135,174.0 135,822.8 10,542.0 |
| Population * Male
* Female
* Urban
* Rural
 | Million  | 1,307.56 673.75 633.81 562.12 745.54 | 1,299.88 669.76 630.12 542.83 757.05  | 1,292.27 665.56 626.71 523.76 768.51 |
| Economically active persons  | Million  | 778.77 | 768.23  | 767.05 |
| Number of employed persons  | Million  | 758.25 | 752.00  | 744.32 |
| Annual Per Capita Income * Urban households
* Rural households
 | Yuan  | 10,493 3,255 | 9,422 2,936  | 5,160 2,090 |
| Annual Per Capita Consumption Expenditure-Urban households  - Rural households  | Yuan  | 7,943 2,955 | 7,182 2,185  | 4,186 1,617 |

*Source: National Bureau of Statistics of China, Chinese Statistical Yearbook, 2006, http://www.stats.gov.cn/tjsj/ndsj/2006/indexeh.htm, accessed December 10, 2008.*

**Exhibit 6**

## CHINA’S TIERED CITIES

Small cities with urban

population smaller than

 million

1

Growing markets with

population larger than

 million

1

Beijing

Shanghi

Guangzho

Shenzhen

Foshan

Chongqing

Chengdu

Tianjin

Wuhan

Shantou

Hangzhou

Xi’an

Shenyang

Nanjing

Ji’an

Dongguan

 Fuzhou Taiyuan

Wenzhou

 Qingdao Kunming

Taizhou

 Changsha Harbin

Ningbo

 Yantai Tangshan

Zhongshan

 Dalian Changchun

Suzhou

 Putian Shijiazhuang

Xiamen Changzhou

 Zibo Huai’an

Wuxi Zhuhai

 Zhangzhou Guiyang

Linyi

Jilin

Urumchi

Xuzhou

Nanchang

Xiangfan

Huizhou

Daqing

Zaozhang

Baotou

Lanzhou

Huzhou

Quanzhou

Shaoxing

Shaoguan

Pingdingshan Bengbu

Zhengjiang

Xinxiang

Jinhua

Zhoushan

Liuzhou

Hengyang

Jiaxing

Yueyang

Baoding

Langfang

Quzhou

Xianyang

Dongying

Baoshan

Nantong

Jinzhou

Huludao

Zhuxhou

**Tier 3b: Poor**

**cousins**

**(**

**484**

 **cities**

**)**

Relatively low income,

b

ut lar

g

e

p

o

p

ulation

b

ase

Wealthy

consumers, but

relatively small

overall market size

Four largest cities with highest

income, large population base,

and lar

g

est GDP scale

Large population,

high income, and

large GDP

*Example*

*Cities*

**Tier 1: Big Four**

**Ti**

**e**

**r 2a**

**:**

**(**

**11**

**Tier 2b:**

**(**

 **cities**

**10**

**)**

**Tier 2c: Mainstream**

**(16**

 **cities**

**)**

**Tier 3a: Next**

**frontier (136 cities)**

*Source Diana Farrell et al., From “Made in China” to “Sold in China”: The Rise of the Chinese Urban Consumer, McKinsey Global Institute, November 2006.*

**Exhibit 7**

## MAJOR COMPETITORS IN CHINA

|  |  |  |
| --- | --- | --- |
|  | **Gome**  | **Suning** |
| Financials (in RMB million) | 2004  | 2005  | 2004  | 2005  |
| Revenue Net profit  |  12,647  486  |  17,959  496  |  9,107  |  15,936  |
| Revenue by geography (%) * Northeast China
* North China
* East China
* West China
* South China
* Central China
 |  |  5  33  9  23  26  4  |  |  3  15  59  5  15  3  |
| Sales per square meter  |  25,940  |  |  32,141  |  23,929  |
| Number of stores  |  442  |  |  94  |  224  |
| Revenue by category (%) * Air conditioners
* Audiovisual
* Refrigerators/Washing

machines - Telecom * Small electrical appliances
* Digital/IT products
* Service
 |  |  16  28  18  16  10  12  –  |  |  |
| Mission  | “Competitive pricing from high volume”  | “Service is the sole product of Suning”  |
| Store formats, positioning  | 1. Traditional (3,500 square meters): price-conscious mass market
2. Digital (260 square meters): high-end customer in downtown
3. Eagle (15,000 square meters): service-conscious, mid to high-end customers
 | Flagship: in large cities Central: the most common  |

*Sources: Gome Electrical Appliances Holdings Limited website, http://www.gome.com.hk/eng, accessed December 5, 2008; Suning website, www.cnsuning.com/include/english, accessed December 5, 2008; Jean Zhou, Deutsche Bank equity research Report, dated April 7, 2006; Sandy Chen, Citigroup equity research report on Gome, dated October 12, 2005*

## Exhibit 8

**BEST BUY AND FIVE STAR – JULY 2006**

|  |  |  |  |
| --- | --- | --- | --- |
| **Metric**  |  | **Best Buy[[18]](#footnote-19)** | **Five Star**  |
| Store size  |  | 86,000 square feet  | 35,000 square feet  |
| Customers  |  | Middle-to upper-income young singles and couples  | Middle-income families Somewhat price sensitive  |
| Service  |  | Mixed-brand packaged solutions displayed by lifestyle requirements  | Personal shopping assistants guiding customers through vendor booths;Attentive  |
| Sales  |  | Led by non-commissioned staff on Best Buy’s payroll  | Led by staff on the payroll of manufacturer  |
| Customer profile  |  | 18–42 years old  | 20–50 years old  |
| Brand identity  |  | Premium full service  | Good price with good services |
| In-store experience  |  | Grab and go  | Guided  |
| Product mix (%)  |  |  | White goods: 16% Air conditioning: 23% Home Entertainment: 25% Digital Products: 7% Cell phones: 13% Kitchen utensils: 9% Small appliances: 5%  |
| Store associates  |  | 100% employed by Best Buy and non-commissioned  | 30% employed by Five Star on non-commission; 70% employed by vendors on commission  |
| Sales growth Gross margin SG&A expense ratio Operating margin Sales per square foot Inventory turn Operating ROA  |  |  |  44%  13.5% 11.5% 2.0% $230  7  5%  |

*Note: SG&A = selling, general and administrative; ROA = return on assets*

*Source: Company files*

1. “Best Buy Snaps up Future Shop for $580 Million,” CBCNews,ca, August 14, 2001, http://www.cbc.ca/money/story/2001/08/14/futureshop140801.html, accessed September 12, 2008. [↑](#footnote-ref-2)
2. Best Buy 10-K filings 2001 p 5. [↑](#footnote-ref-3)
3. Ibid. 4

 www.ce.org/research/US.CE industry growth 2004-2009(e), referenced March 31, 2009. [↑](#footnote-ref-4)
4. Consumer Electronics Association, “Global Consumer Electronics Industry Will Grow to $700 Million by 2009, CEA/GfK Study Finds,” press release, July 9, 2008, http://www.ce.org/Press/CurrentNews/press\_release\_detail.asp?id=11535, accessed March 31, 2009. [↑](#footnote-ref-5)
5. Diana Farrell et al., From “Made in China” to “Sold in China”: The Rise of the Chinese Urban Consumer,’ McKinsey Global Institute, November 2006. [↑](#footnote-ref-6)
6. Instat, “China’s Consumer Electronics Manufacturing Will More Than Double by 2010,” press release, October 11, 2006, http://www.instat.com/press.asp?ID=1768&sku=IN0602785CSM, accessed November 28, 2008. [↑](#footnote-ref-7)
7. In May 2008, Best Buy and Carphone Warehouse announced the creation a new joint venture company, in which Best Buy acquired 50% of The Carphone Warehouse's European and U.S. retail interests for a cash consideration of £1.1 billion, or US$2.1 billion. [↑](#footnote-ref-8)
8. Jean Zhou, Deutsche Bank equity research report on Suning Appliances, dated April 7, 2006. [↑](#footnote-ref-9)
9. Andrew Grant, “The New Chinese Consumer,” The McKinsey Quarterly, Special Edition, June 2006 p 1. [↑](#footnote-ref-10)
10. Claudia Suessmeth-Dykerhoff et al., “Marketing to China’s New Traditionalists,” Far Eastern Economic Review, April 2008. p 29. [↑](#footnote-ref-11)
11. Kevin P. Lane et al., “Building Brands in China,” The McKinsey Quarterly, Special Edition, June 2006.p 39. [↑](#footnote-ref-12)
12. Normandy Madden, “Tier Tale: How Marketers Classify Cities in China,” Advertising Age, March 19, 2007 p 21. [↑](#footnote-ref-13)
13. Sandy Chen, Citigroup equity research report on Gome, dated October 12, 2005. [↑](#footnote-ref-14)
14. Russell Flannery, “Best Buy’s Art of War,” Forbes.com. http://www.forbes.com/services/forbes/2007/1015/066.html, accessed November 27, 2008. [↑](#footnote-ref-15)
15. Sandy Chen, Citigroup equity research report on Gome, dated October 12, 2005. [↑](#footnote-ref-16)
16. Jean Zhou, “Suning Appliance,” Deutsche Bank Equity Research Report dated April 7, 2006. [↑](#footnote-ref-17)
17. Russell Flannery, “Best Buy’s Art of War,” Forbes.com, http://www.forbes.com/services/forbes/2007/1015/066.html, accessed November 28, 2008. [↑](#footnote-ref-18)
18. Best Buy was yet to open its store in China as of June 2006. [↑](#footnote-ref-19)