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best buy’s exit from china: what went wrong?[[1]](#endnote-1)

Professors Shaofei Wang, Shih-Fen Chen, Feng Guan and Sida Gao wrote this case 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.

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On December 4, 2014, Best Buy Co., Inc. (Best Buy), the Minnesota-based retail consumer electronics giant, announced its complete pullout from China. In 2003, Best Buy had opened its first office in Shanghai to source consumer electronics from Chinese companies for sale in the United States. Three years later, it entered the Chinese market by acquiring Jiangsu Five Star Appliance Co. (Jiangsu Five Star), an appliance chain with 136 locations in seven Chinese provinces.[[2]](#endnote-2) The first signature Best Buy store opened in Shanghai in 2009, and the store count rapidly grew to nine. However, in about two years, events turned against Best Buy. In 2011, the retailer decided to close all nine Best Buy stores in China, and three years later, it announced it would sell the Jiangsu Five Star chain to a real estate developer.[[3]](#endnote-3) What had gone wrong with Best Buy’s China strategy?

COMPANY HISTORY

In 1966, Richard M. Schulze and Gary Smoliak founded an audio specialty store selling high fidelity (hi‑fi) stereos in Saint Paul, Minnesota. They called the store Sound of Music. Three years later, Schulze bought out his partner and added two more stores to this fledgling company, both through acquisitions. In 1978, Sound of Music grew to operate nine stores, all in the state of Minnesota,[[4]](#endnote-4) and in 1983, Schulze renamed the company Best Buy and expanded the chain’s offerings to include records, videocassettes, home appliances, and other consumer electronics.[[5]](#endnote-5) He wanted to shape Best Buy into a high-volume chain that offered low prices in a no-frills retail environment.

Schulze’s concept of a high-volume discount chain originated from an incident that occurred at one of his stores in 1981.[[6]](#endnote-6) The store, in Roseville, Minnesota, was hit by a tornado, and although the store was severely damaged, the products inside were left intact. Schulze decided to have a “tornado sale” in the parking lot of the damaged store. To attract shoppers, he advertised the event heavily and promised “best buys” on everything. The tornado sale was a huge success.[[7]](#endnote-7)

After renaming his company in 1983, Schulze introduced the first Best Buy store based on the high-volume discount concept in Burnsville, Minnesota. In the first year, this store outperformed all other stores—that were still using the Sound-of-Music concept. It was clear to Schulze that a high-volume discount chain was the key to the future of Best Buy.

Evolution of Store Concept

The success of the tornado sale shaped the high-volume discount concept in several ways:

**Store size**: All Best Buy stores were large in size and rich in product variety. High-volume stores were expected to act as magnets and to have the power to attract shoppers from a large geographic area. One way to generate this power was to expand product offerings and provide the benefits of one-stop shopping for those customers who lived dozens or even hundreds of miles away from the store.

**Open display**: With only a few exceptions, all items carried by Best Buy stores were displayed openly for shoppers to touch, inspect, and experience. Although sales personnel were available to help shoppers in Best Buy stores, they were not really necessary. A shopper could enter a store, pick up an item, inspect it, check it out, and leave the store without ever talking to a store clerk. Best Buy’s self-help model reduced the size of its sales forces and thereby the costs of store operations.[[8]](#endnote-8)

**No pressure sales**: Best Buy got rid of commission-based compensation for its sales force as a way to create a pleasant atmosphere for shoppers.[[9]](#endnote-9) This no-pressure sales technique reduced the role of sales teams to that of providing product information. The absence of sales pressure raised sales clerks’ credibility with shoppers and enhanced the quality of service in the stores.

**Location choice**: As the large-volume discount concept became more widely accepted, Best Buy began to face competition in the market. In choosing store locations, Best Buy tried to stay away from its major rival, Circuit City. Most Best Buy stores were located right next to large shopping areas or inside shopping malls, which served as magnets to attract shoppers in big enough numbers to support the large-volume concept.

**Store decoration**: All Best Buy stores were simple in layout and decoration. Shoppers did not really care that they were shopping in a warehouse-like environment as long as the price was right (and they had showed this during the tornado sale in the parking lot). A no-frills physical environment worked for the discount concept, since it allowed Best Buy to preserve its retail margins by driving down construction costs.

The industrial-style stores served Best Buy well until the late 1980s, when personal computers (PCs) started to gain popularity among household users. Previously, PCs had been sold through specialty stores that had the capacity to provide intensive pre-sales training for buyers of both hardware and software. As the popularity of PCs grew, shoppers became more knowledgeable about the products, and this in turn allowed PCs to migrate from specialty stores to general merchandisers, including Best Buy.

The stocking of PCs prompted Best Buy to introduce a new store concept called Concept II, which was introduced in 1989. These Concept II stores were more brightly lighted and more fashionably decorated.[[10]](#endnote-10) The Concept II stores were revamped as Concept III stores in 1995. Larger in size than the Concept II stores, the Concept III stores aimed to provide shoppers with even more information through interactive experiences with a wide range of products, including PCs, video games, and surround-sound stereo systems.

The Concept III stores were modified again three years after their introduction, in 1998. Called Concept IV, these modified stores were relatively smaller in size. One major revision was that cash registers were located all over the stores. To make it easier for shoppers to find the items that they were looking for, Concept IV stores featured an open layout that was partitioned by product categories. They also had a large area designated for demonstrating home theatre systems.

Growth through Acquisitions

With the introduction of new store concepts and the addition of more locations, Schulze watched as Best Buy grew organically up to the late 1990s. The company—which was first traded on the NASDAQ exchange in 1969, when it was still named Sound of Music—was listed on the New York Stock Exchange in 1987 and included in the Standard & Poor’s (S&P) 500 index in 1999.

At the beginning of the new millennium, Schulze engineered a series of acquisitions to diversify into new businesses and new geographic areas, marking the beginning of Best Buy’s growth through acquisitions. In 2000, Best Buy acquired Magnolia Hi-Fi, Inc., an audio-video retailer that operated in the western United States. During the same year, it also took over a music label called Redline Entertainment, Inc., which allowed it to integrate backward into content production. Best Buy continued this acquisition strategy in 2001, acquiring such targets as Musicland Stores Corporation (a retailer of home entertainment products) and Future Shop Ltd. (a Canada-based electronics chain).

In 2002, Brad Anderson, a veteran at Best Buy, succeeded Schulze as the company’s chief executive officer (CEO). Anderson followed in Schulze’s footsteps by acquiring more companies to diversify Best Buy’s business. The most notable target was Geek Squad, a Minneapolis-based company that provided on-site repair services for household PC users. Geek Squad ran operations in Chicago, Los Angeles, and San Francisco in addition to Minneapolis.

One year after Anderson took over as CEO, the number of Best Buy stores reached 600 in the United States. The driving force behind this growth was the advancement of PC technology and the rapid increase in the number of PC users. The strategic importance of Geek Squad’s computer repair service to Best Buy’s growth had become clear to Anderson, who tried to create Geek Squad “precincts” in every Best Buy store. The rollout was complete in October 2004, and Best Buy also opened Geek Squad precincts in stand-alone and store-in-store locations.

During Anderson’s tenure, the retail consumer electronics business experienced several significant transitions, two of which were particularly critical to Best Buy’s operation. The first was the emergence of Internet shopping; computer-savvy shoppers patronized virtual stores to purchase a wide range of consumer electronics. The second was the rise of China as a producer of consumer electronics with substantial cost advantages, which led to severe price competition at the retail level worldwide.

The combination of Internet shopping and retail price competition pressed Brian Dunn, who replaced Brad Anderson as the CEO in June 2009, to introduce several strategic moves. These included revising the large-volume discount concept of Best Buy stores in response to the threat of Internet shopping. Best Buy also expanded its business model to foreign countries in response to retail price competition at home.

Responses to Internet Threat

The prevalence of Internet access in the 1990s created a new commercial format: online shopping. Without the traditional bricks-and-mortar stores, online retailers appealed directly to consumers with lower prices, free shipping, and often exemptions from sales taxes. During the Internet bubble in the early 2000s, online retailers proliferated to cover a wide range of products, including books, toys, pet foods, drugs, and groceries.

Amazon.com, Inc. (Amazon) was the biggest Internet-based retailer in the United States. Founded as an Internet bookstore in 1994, it quickly expanded to include digital products (for example, books, DVDs, music CDs, videotapes, and software) and physical goods (including apparel, baby products, health and personal-care items, industrial and scientific supplies, kitchen items, jewellery, and watches).

Of the physical products offered by Amazon, consumer electronics were among the most promising, for good reasons. First, the high value of most consumer electronics helped justify the extra costs of e‑commerce, particularly shipping costs. Second, a small number of reputable brands dominated the market for consumer electronics. Strong brands, along with highly standardized products, made searching much easier for Internet shoppers.

However, there were also drawbacks to shopping online for consumer electronics. Most consumer electronics required intensive pre-sale demonstrations that e-stores could not offer. Product sophistication also meant that damage was likely to occur during shipping. The costs of mishandling could also be quite high, due in part to the expense of returning products. While the shipping issue had become less of a problem in recent years because advances in technology meant most consumer electronics had become smaller, the issue of pre-sale demonstrations remained a barrier to e-retailing of consumer electronics.

As online shopping for consumer electronics became popular, Amazon’s customers found an easy way to get the pre-sale demonstrations that they could not obtain from e-stores. Before placing an order with Amazon, they simply went to a nearby Best Buy store, inspected the product, received pre-sale services, said “thank you” to the sales clerk, and left the store without purchasing the product. Instead, they ordered the product from Amazon and paid a lower price. Simply put, e-shoppers had turned Best Buy stores into Amazon showrooms.

In 2009, Best Buy experienced a 2 per cent decline in store sales for the first time in 20 years.[[11]](#endnote-11) About the same time, Best Buy’s major rival, Circuit City, announced it would be closing 567 stores by March 2009.[[12]](#endnote-12) The future of Best Buy was in doubt, and this prompted Dunn to fight back against Internet shopping through a number of bold actions.

The first step Best Buy took to protect its market position was to expand the number of private-label products sold exclusively at its own stores.[[13]](#endnote-13) Best Buy introduced hundreds of electronic items under labels from five house brands, including Insignia and Dynex televisions, Rocketfish video cables, and Geek Squad flash drives. The expansion of private-label products made it difficult, if not impossible, for online shoppers to compare prices. The downside was that promoting private brands might strain relationships with those suppliers who were competing with Best Buy. Private labels were also less likely to succeed in categories that featured rapid technology changes (for example, flat panel TVs) or strong manufacturer brands (for example, Apple).

Next, Best Buy updated its online business to compete directly with e-retailers. To begin with, Best Buy announced it would match the discount prices provided by e-retailers at its stores. This price protection program directly tackled the “Amazon showroom” issue that had troubled Best Buy for some time. To take advantage of its over 1,400 stores across the United States, Best Buy introduced an instore-pickup program, whereby shoppers could buy items online but pick them up at nearby stores. Best Buy also offered free shipping for orders over US$25,[[14]](#endnote-14) and it allowed shoppers to return to nearby stores any items that they ordered online but did not like.

Moreover, Best Buy took major actions to improve the efficiency of its store operations. It did this first by adopting a redesigned “connected store” format with a centralized desk for the Geek Squad service and a store-within-a-store format. Best Buy also introduced Best Buy Mobile, a small stand-alone store that sold only mobile devices.

“We are taking major actions to improve our operating performance,” said Dunn. “As part of our multi-channel strategy, we intend to strengthen our portfolio of store formats and footprints—closing some big box stores, modifying others to our enhanced Connected Store format, and adding Best Buy Mobile stand-alone locations.”[[15]](#endnote-15)

Shortly after announcing this multi-channel strategy, Dunn resigned in April 2012 because of allegations of personal misconduct. Five months later, Hubert Joly joined Best Buy as the new CEO. Before Christmas 2012, Joly announced his “Renew Blue” strategy that sought a balance between instore and online operations, that is, making its instore services available to online shoppers—an advantage that e-retailers could not easily replicate. During the 2012 shopping season, the decline in sales at Best Buy stores finally stopped, and its online revenues increased by 10 per cent.[[16]](#endnote-16) The actions taken by Best Buy to fight back against online shopping seemed to be working.

The number of Best Buy’s big box stores peaked in 2012, at 1,103, and the number of Best Buy Mobile locations had grown from zero to 305 during Dunn’s tenure. At the end of 2014, about two years after Joly joined the company, the number of Best Buy stores in the United States was reduced to 1,055, but the number of Best Buy Mobile locations was raised to 406.[[17]](#endnote-17) Best Buy also operated 136 regular stores and 56 mobile stands in Canada, the only foreign country where Best Buy found success in its 13 years of international expansion.

International Expansion

Founded in Minnesota in 1966, Best Buy had remained in the United States until 2001, the year it started to venture into foreign countries. The first stop in Best Buy’s international expansion was Canada. On August 14, 2001, Best Buy announced its acquisition of Future Shop, an electronics chain that operated 88 stores across Canada. Best Buy intended to keep Future Shop as a separate subsidiary.[[18]](#endnote-18) One year later, in September 2002, Best Buy opened its first signature store in Mississauga, near Toronto, Ontario.[[19]](#endnote-19)

China was the second stop in Best Buy’s overseas expansion but as a sourcing site instead of a target market. The rise of China as a worldwide production hub for consumer electronics had not escaped the attention of Best Buy. To gain access to low-cost vendors in China, Best Buy opened its first global sourcing office in Shanghai in September 2003. In January 2004, Best Buy established a wholly owned trading company in Shanghai, and then opened two branch offices in Shenzhen and Beijing, respectively. Best Buy used this trading company to handle all sourcing activities in China.[[20]](#endnote-20)

Almost three years after Best Buy started its sourcing operation in China, the company acquired a majority stake in Jiangsu Five Star, the fourth-largest appliance chain in China, which operated 146 stores across seven provinces.[[21]](#endnote-21) In January 2007, Best Buy opened its first branded store in Shanghai and converted its sourcing operations in China to include the business of retailing electronics.[[22]](#endnote-22)

From 2008 onward, Best Buy embarked on a series of overseas expansions. In February 2008, it opened a store in San Juan, Puerto Rico. In May 2008, it bought out 50 per cent of the retail operation owned by Carphone Warehouse, a London-based mobile phone distributor in the United Kingdom. Seven months later, Best Buy opened a store in Mexico and then another store in Izmir, Turkey. In April 2010, Best Buy opened its first signature store in the United Kingdom, having waited about two years after its initial entry into that country.

What followed was a series of setbacks in Best Buy’s international operations. In early 2011, the company announced the closure of its two Turkish stores and all nine of its Best Buy stores in China. At the end of 2011, the company also shut all 11 Best Buy stores in the United Kingdom. The only foreign locations where Best Buy’s signature stores could survive and grow were in North America: the company had 79 stores in Canada, three in Mexico, and three in Puerto Rico at the end of 2013.

Best Buy’s acquisitions of foreign retailers did not work out well either: in April 2013, Best Buy sold its 50 per cent stake in Best Buy Europe back to its joint venture partner, Carphone Warehouse;[[23]](#endnote-23) more than one year later, it sold Jiangsu Five Star to a real estate developer;[[24]](#endnote-24) and on March 28, 2015, it announced the closure of all Future Shop stores in Canada.[[25]](#endnote-25) The divestments of these acquired units translated into the loss of thousands of stores run by Best Buy in the United Kingdom, China, and Canada.

The most spectacular failure of Best Buy’s foreign expansion occurred in China. Best Buy had first announced the acquisition of Jiangsu Five Star in 2006, prior to opening its branded stores in China in 2007. Up to 2011, right before the closure of all its branded stores, Best Buy had achieved a meagre 1.8 per cent share of the Chinese market.[[26]](#endnote-26) This share did not grow any higher until the Jiangsu Five Star chain was sold in 2014. After only eight years, Best Buy pulled out of the Chinese market completely to “focus more on our North American business,” according to CEO Joly[[27]](#endnote-27).

BEST BUY’S ENTRY INTO CHINA

Best Buy’s invasion of the Chinese market started in 2006 with the acquisition of a 51 per cent stake in the country’s fourth-largest appliance chain, Jiangsu Five Star, for a price of $180 million. Best Buy’s game plan for the Chinese market was to leverage the bargaining power of global sourcing to enhance the competitiveness of Jiangsu Five Star. Best Buy also could deploy the knowledge it had accumulated in the United States to improve the operational efficiency of the chain it had acquired in China.

Following the model it had used in its expansion to Canada, Best Buy soon introduced signature stores in China, introducing nine stores over 46 months, all located in prime shopping areas (for example, the Xujiahui shopping district in Shanghai, the Industrial Park In City Shopping Centre in Suzhou, and the MIXC Mall in Hangzhou). Best Buy adopted a Chinese name for its stores (百思买), based on the phonetic translation of the company name. Even though the opening of each Best Buy store in China attracted intensive media attention and heavy shopper traffic, sales were anemically low. Only 51 months after opening the first Best Buy store at a prime location in Shanghai, the company announced the closure of all nine stores bearing the Best Buy name (百思买).

When Best Buy announced the closure of its branded stores in China, it also vowed to retain the Jiangsu Five Star chain the company had acquired earlier.[[28]](#endnote-28) As noted by Best Buy’s CEO Dunn, the Jiangsu Five Star model was “profitable and ha[d] significant growth opportunities.”[[29]](#endnote-29) Best Buy planned to add 40 to 50 locations to the Jiangsu Five Star chain. However, 46 months later, it announced it was pulling out of the Chinese market and selling the chain. Its earlier promise to add 40 to 50 stores to the chain sounded hollow, as the chain had only 184 locations when it was sold to a real estate developer—a net increase of 48 stores over an eight-year period under Best Buy’s ownership[[30]](#endnote-30) (see Exhibit 1).

Critics quickly pointed the finger at Chinese consumers, who were said to enjoy haggling over prices at discount stores. Although Best Buy was positioned as a discount store in the United States, it was perceived as an expensive brand by Chinese shoppers. Yet the reasons for Best Buy to pull out from China were more complicated than consumer behaviour. Insufficient adaptation of Best Buy’s business model to the retailing environment in China could have been the real culprit.

Distribution of Home Appliances and Consumer Electronics in China

In 2014, China was the world’s largest and fastest-growing market for household appliances and consumer electronics; retail trade revenues in the two sectors reached $123.2 billion and had a growth rate of 11.2 per cent annually.[[31]](#endnote-31) An increasing portion of the 1.4 billion people in China lived in urban areas, which had compact housing and heavy street traffic. However, the behaviour of Chinese shoppers differed substantially from that of Best Buy’s U.S. customers in a number of ways.

**Settlement patterns**: China was an agricultural society with a relatively short history of industrialization. It featured a collectivist culture, where most people, even farmers, had long lived in compact villages with rather limited mobility. The economic reforms over the past three decades had triggered a wave of urbanization that placed 55 per cent of the population in cities of more than 749 million residents.[[32]](#endnote-32) High‑rise buildings could be seen all over Chinese cities, which had busy vehicular and pedestrian traffic.

Zoning in China was unique in that commercial and residential properties were not separated horizontally, as normally seen in U.S. cities. Instead, zoning in Chinese cities was vertical: stores, offices, and apartments could all be located in the same building (e.g., stores were on the ground floor, offices were between the second and fifth floors, and apartments were on the sixth floor and up). This vertical zoning concept was meant to allow people to live, work, and shop without leaving the building.

**Shopping patterns**: Chinese shoppers preferred to visit neighbourhood stores within walking distance, often on a daily basis. Although car adoption rates had increased at an astonishing pace in China, they had not really affected this shopping pattern. Overall, consumers in China were highly price sensitive because the population had only recently moved out of poverty. Thanks to a rise in disposable income, more and more shoppers became brand conscious and willing to spend on pricey items that were seen as status symbols.

The primary buyers of household appliances in China were end-users since houses and apartments were sold without these items, and most shoppers buying household appliances and consumer electronics were buying such items for the first time—that is, without prior consumption experience. The adoption of new devices was quick, especially among young people who had grown up as the only children in their families. When buying consumer electronics, Chinese shoppers were more willing to pay for hardware than for software, and some stores even installed unlicensed computer software for shoppers without charging a fee. Chinese shoppers appreciated good service, but they also expected to receive it for free. Tipping for excellent service was not the norm in Chinese society.

**Retail trade**: China had been a world production centre for decades, but most of the items made in Chinese factories had been exported to foreign markets rather than sold to end-users at home. Overall, retail trade infrastructure in China was set up to handle mainly agricultural produce for local consumption. Mass distribution of manufactured goods for nation-wide consumption was relatively new in the Chinese market. Retail trade in China was also highly fragmented; family-owned stores and street vendors carried nearly all items that households purchased on a daily basis. The main function of these retailers was to make products accessible to shoppers without adding value to the product. Price competition, therefore, was the primary tool used by most retailers to attract shoppers.

Intensive price competition reduced the ability of retailers to differentiate their services. Household appliances, for instance, were sold mostly through independent retailers that were too small to offer high‑quality store services. The role of storeowners was not to disseminate product information, but to negotiate with shoppers over prices. In cases where an appliance store did provide pre-sale or after-sale services, shoppers expected to receive them for free. Unable to recoup their operation costs through a service premium, most appliance stores simply resorted to price competition.

The same bare-bones operating style could also be found in the distribution of consumer electronics in China. Most retailers did not display hand-held gadgets openly. Instead, they stocked these products in a cabinet and did not allow shoppers to touch or inspect them. Store clerks usually refused to hand the devices over to shoppers unless the shoppers had clearly expressed an intention to purchase. Most sales at retail stores in China were considered final, since the stores would not accept product returns. As long as product prices were right, poor retail service did not seem to bother shoppers that much.

**Rise of appliance chains**: The retail trade in China remained fragmented overall, but the distribution of household appliances and consumer electronics had achieved a certain level of concentration. When Best Buy acquired Jiangsu Five Star, the target firm was a fledgling start-up ranked number four out of 30 appliance chains in China. The three leading rivals were GOME Retail Holdings Limited (Gome), Suning Commerce Group Co., Ltd. (Suning), and Yongle (China) Electronics Retail Company Limited (Yongle). Later, Suning and Yongle merged to become a single chain, and by the time Best Buy withdrew from China in 2014, the Jiangsu Five Star chain was operating in 184 locations—an increase of 48 stores over the eight years under Best Buy’s ownership. During the same period, Gome and Suning grew their store numbers by 311 and 1,299, respectively.

Chinese appliance chains chose to open their stores in prime shopping areas of the city. The properties in such areas were independently owned by multiple landlords, so after an appliance store had successfully developed its clientele, competing stores could pop up next door or across the street at any moment. There was no way to enforce exclusivity clauses in the lease contracts, and this meant that stores from multiple chains could be found on a single block, within walking distance of each other. In addition to the flagship appliance stores, shoppers could also visit many stand-alone stores or street vendors. The proximity of all retailers within a street block made price haggling easier for shoppers (see Exhibit 2).

American-style shopping malls, which made it easier for large-volume chains to survive in other parts of the world, were not found in China. These malls provided parking spaces, which could increase the geographic coverage of a store because shoppers could drive to patronize the mall. In addition, real estate developers could limit the number of competing chains in a particular mall, making it easier for retailers to maintain a reasonable distance from their rivals. The variety of stores found in a shopping mall also generated magnetic power that attracted more patrons.

**Online shopping**: China was one of the most wired nations in the world; Internet users accounted for 50.3 per cent of the population.[[33]](#endnote-33) Online shopping was an after-hours passion for many Internet users, especially the younger generation. E-commerce boomed in China for several reasons. The retail trade was not fully developed to serve the market, and this created room for e-retailers to enter and survive. There was an abundant supply of unskilled labour, which lowered handling and shipping costs for e‑retailers, and high population density further improved delivery efficiency. Low costs and low prices were therefore the main attractions of online shopping in China.

China had two major e-commerce sellers of household appliances and consumer electronics: Jingdong Group Co., Ltd. (Jingdong) and Tianmao. Jingdong used three revenue models to serve online shoppers. First, it paid cash to procure merchandise for resale to online shoppers at a margin of around 5 per cent, which meant its products were 10–25 per cent cheaper than those sold through physical stores. Second, it provided its Internet platform to outside entrepreneurs at a fee, which was equivalent to renting out its e-store space to other suppliers. Third, Jingdong generated income from online advertisements placed on its web pages.

Jingdong’s e-commerce operations started in 2004. In all, it had 20 million registered users and 1,200 vendors covering a wide range of product categories, including household appliances, consumer electronics, home decoration, apparel, food, baby clothes, and books. More than 700,000 items were available for sale on Jingdong’s online platform. The site drew 35 million daily clicks and 150,000 daily orders. With a market share of 34 per cent, Jingdong was the leading player in the business-to-consumer (B2C) e‑commerce segment in China.

Tianmao was a subsidiary of Alibaba, the e-commerce giant founded by Ma Yun in Hangzhou. Tianmao did not take positions on the products sold through its platform. Instead, it merely collected a fee from the suppliers who placed products on its online platform for sale to consumers. Tianmao had attracted 15,000 business users who sold their products under 20,000 brand names. In addition to collecting a fee from its platform users, Tianmao also drew income from online advertisers.

Tianmao also served as a system integrator for the users of its online platform as part of Alibaba’s business-to-business (B2B) operations. Tianmao’s services included data analysis, customer management, and software development and maintenance. Strictly speaking, Tianmao only built an Internet platform for online marketers to compete with offline marketers. It did not compete directly with physical stores in the B2C e-commerce segment.

What Went Wrong with Best Buy’s Entry into China?

The strategy Best Buy adopted in entering the Chinese market was exactly the same strategy it had used to enter Canada. Best Buy had entered Canada by acquiring an existing chain and keeping it as a separate subsidiary. After gaining enough experience from the acquired chain, Best Buy started to open its own signature stores in Canada, replicating its home business model abroad. As its branded stores reached a critical mass, Best Buy shut down some of the acquired stores or converted them into its own branded stores. The entry was smooth and successful.

When Best Buy took over the Jiangsu Five Star chain to enter China, it followed up by introducing its branded stores. What happened next was that Best Buy closed all its own stores; its store number never surpassed 10. Three years later, Best Buy put the acquired chain on the market for sale and pulled out of the Chinese market completely. While the concept of high-volume discount stores worked quite well in Canada, it failed in China. The question was why?

Critics pointed out two problems with Best Buy’s replication of its U.S. store concept in China:

First, while Best Buy was positioned as a discount chain in the United States, it was perceived as a premium brand by shoppers in China. In fact, the no-frills shopping environment that made Best Buy famous in the United States looked fashionable and luxurious to Chinese shoppers, who regularly patronized street vendors. Relative to local rivals, which offered almost no store services, Best Buy was a full-service chain that must be supported by premium prices. The prime location of most Best Buy stores further confirmed the premium positioning of the brand. Best Buy’s flagship store in Shanghai, for instance, was located in the exclusive and expensive Xujiahui shopping district. The puzzle was that such premium positioning did not seem to affect other U.S. firms in China. Apple, for example, sold more iPhones per square foot in its Shanghai store than in any stores in the world, despite the fact that the iPhone was priced 30 per cent more in China than in the United States.

Second, Best Buy replicated its high-volume concept by building big flagship stores in densely populated cities in China. Although Best Buy enjoyed a scale advantage at the store level, it did not increase its total store count rapidly enough to match its local rivals at the corporate level. Best Buy’s branded stores never went outside of metropolitan Shanghai, including Hangzhou and Suzhou. By the time Best Buy put the Jiangsu Five Star chain up for sale, its store count was still 184—far below the store numbers of its two rivals (Gome at 1,100, and Suning at 1,200).[[34]](#endnote-34)

One could argue that Best Buy, as an American company, lacked the political and business connections to secure enough prime properties for its branded stores in China. However, the Jiangsu Five Star chain that was based in Jiangshu and operated as a separate subsidiary after Best Buy took it over also grew slowly.

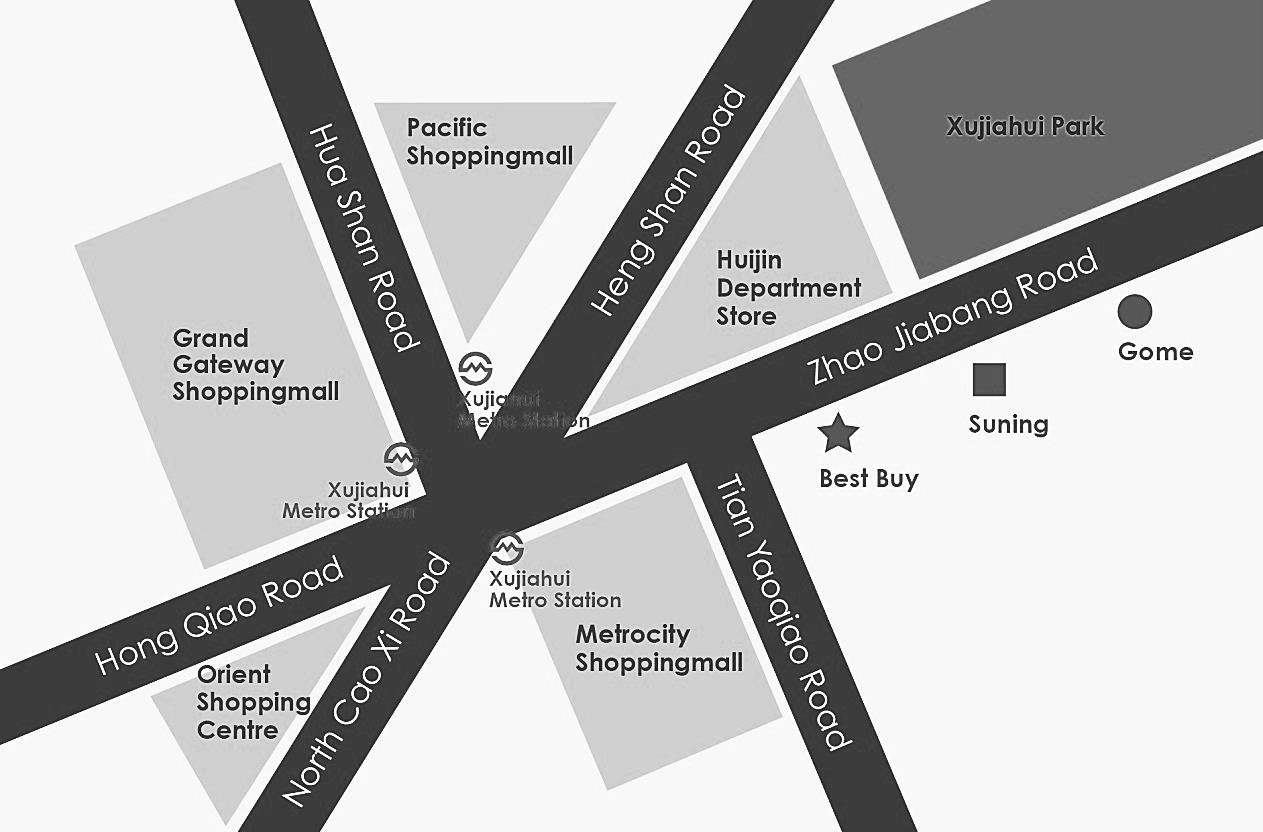
Whereas Best Buy failed to replicate its store concept in China, its operation model was copied by local chains. Shortly after Best Buy entered China, both Gome and Suning started to display products openly for shoppers to inspect and experience. They also improved instore service and banned the practice of price haggling. The Chinese version of Best Buy’s operating model seemed to work out well for Gome and Suning.[[35]](#endnote-35) If Best Buy’s operating model also worked in China, what had gone wrong with the company’s strategy in China?

Exhibit 1: Distribution of Store accounts Across Key provinces in China

|  |  |  |  |
| --- | --- | --- | --- |
| **Location** | **Five Star** | **Gome** | **Suning** |
| Zhejiang | 18 | 185 | 115 |
| Jiangsu | 122 | 250 | 374 |
| Anhui | 19 | 51 | 86 |
| Yunnan | 6 | 57 | 47 |
| Sichuan | 7 | 130 | 111 |
| Henan | 11 | 120 | 82 |
| Shandong | 10 | 283 | 131 |

Source: Created by the authors using data from “Top 100 Chain [in Chinese],” CCFA: China Chain Store & Franchise Association, accessed December 7, 2017, www.ccfa.org.cn/portal/cn/hangybzhun.jsp?lt=31&pn=5&pg=1.

Exhibit 2: Best Buy’s flagship Store in Shanghai and the Surrounding Area



Source: Case authors.

Endnotes

1. This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of Best Buy Co, Inc. or any of its employees. [↑](#endnote-ref-1)
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