



International Insider Series:

Global Retail and Distribution



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Introduction: Retail Overhaul

Shopping patterns are changing, worldwide. The growing middle class in emerging economies is creating a larger customer base with the financial resources to buy consumer electronics products. At the same time, the retail and distribution infrastructure for selling such merchandise is in flux. Cultural traditions favoring small, neighborhood markets are being supplemented with large retail emporia offering greater selections and better prices. In some countries, including China and the Arabian (Persian) Gulf region, government policies are encouraging retail development in order to bring more productive, useful and entertaining products closer to more people.

In emerging economies – especially powerhouses such as China, India and the United Arab Emirates – retailing is in a fast and dramatic transition. The expansion of American, European and Asian big-box retailers is part of this evolution in many countries, and there also are major entrepreneurial retailing initiatives from domestic merchants.

The significance of electronics retailing in these regions is reshaping the scale and scope of the global marketplace. Despite the worldwide economic crunch, during 2009 CE sales in China will account for nearly 15 percent of global CE revenue, trailing only North America (22 percent share) and Western Europe (16 percent share). Middle Eastern countries, especially the countries along the Persian (Arabian) Gulf with their “destination shopping” position, will account for 4.4 percent of 2009 global CE sales.¹

Unique local conditions affect the nature of each market; at the same time, there are many consistencies in CE retailing around the world. For example, retail categories such as mobile phones, portable navigation devices (GPS systems), LCD TVs and next-generation DVD players (such as Blu-ray disc) remain strong sellers in almost every global market.

For global retailers, opportunities in emerging markets are strong, according to many independent analysts.

“Even when faced with tough economic conditions in their home markets, they can realize continued double-digit same-store sales growth and profits in their emerging markets,” according to an A.T. Kearney report.² The Kearney index for overall global retail opportunity lists China, India, Russia and Vietnam along with several Middle Eastern/North African and

Latin American nations as the top ten retail opportunities. The scale of global CE retailing, and its ability to weather the current economic slowdown, is further underscored by recent sales statistics. GfK Asia, in its *2008 Mid-Year Pan Asia Consumer Electronics Data Summary*, tallied that the region’s growing CE sector generated about \$11.5 billion U.S. during the first half of 2008, up 13 percent from the previous year. The study includes data from 13 countries. Just within the high-definition TV category, retail sales value increased nearly 350 percent compared to the first half of the previous year. The total HDTV market value was just over \$190 million U.S. The GfK survey also identified strong and growing sales for personal navigation devices.³

Competition from Domestic Merchants

As business opportunities increased, retailers in the emerging markets have expanded rapidly. In its annual survey of the world’s “Top 250” global retailers, Deloitte Development LLC noted that for the first time retailers from China and Russia were among the 18 companies that were on its list for the first time. Two of the four Chinese retailers on Deloitte’s roster specialize in consumer electronics and home appliances: Suning Appliance Company and GOME collectively control about 20 percent of the Chinese market in these categories.⁴

The Deloitte analysis also measured companies and their home countries on the “Q ratio,” an evaluation tool that gauges a publicly owned company’s market capitalization to the value of its tangible assets. A ratio of greater than 1.0 means that financial markets put substantial value on the company’s non-tangible assets such as brand equity, differentiation, innovation, first-mover advantage, market dominance and customer loyalty.

The Q ratio composites for Chinese companies topped the list at 4.982. In comparison, U.S.-based companies collectively scored 1.421, U.K. merchants had a 1.256 Q ratio and Japanese retailers scored 0.586. On an individual basis, China’s Suning had a 10.916 Q ratio, putting it in Deloitte’s #3 position globally; GOME’s score of 2.501 put it in the #21 position.⁵

Challenges in Emerging Economies

“Organized retailing” is the term used to describe the structured supply chain leading to retail chains and big box merchants. These “organized” stores operate with a regimen that includes inventory maintenance, consistent pricing,



support services, competitive products from multiple manufacturers and other aspects of modern Western merchandising.

In contrast, in the souks of the Middle East, the sprawling bazaars of Asia and the dark, narrow shops of isolated neighborhoods is the vast world of “unorganized retailing.” Small, stand-alone merchants with limited stock handle the vast majority of retail sales in emerging countries: 96 percent in India, 83 percent in China, 65 percent in Brazil and 60 percent in Thailand.⁶

As organized retailers seek a foothold in these emerging economies, the evolving cultural and financial environment poses special challenges, differing somewhat among markets but with striking similarities.

- Familiarizing customers with how to shop in the structure and process of an organized environment.
- Recruiting and training employees is a major hurdle in communities that are unfamiliar with modern selling and service tactics. Companies have had to establish instructional programs to bring potential employees up to a required level of product awareness and technical expression. Best Buy delayed opening its first China store to allow more time for employee training.
- The high cost and availability of real estate is a problem in many urban locations, especially when retailers from many sectors are seeking to establish a presence in that market.
- Customer loyalties are often strong, especially in communities where shoppers have long-standing relationships with mom-and-pop stores, even though such stores have very limited inventory.
- Unreliable roads and transportation systems can unexpectedly impede delivery of products as scheduled and expected.
- Distribution and fulfillment are occasionally whimsical. Retailers frequently receive half the order they expect, with no advance indication of what products will be missing or explanations of why deliveries are so haphazard.

One CE retailer cited the reason that his company first expanded in China but not in India: the lack of a reliable supply chain. The company explored a move into India, but was unable to win assurances from suppliers and distributors that merchandise would be available to meet the retail giant’s operating process.⁷

Different Operating Procedures

Retail and distribution tactics vary widely in the most promising emerging economies. International companies face operating conditions that often are fundamentally different than those in more established markets.

- Some countries require partnering with a domestic firm in order to obtain necessary licenses for retail or distribution.
- There may be local requirements on minimum capital contributions, the number of directors and shareholders and incorporation procedures.
- Traditional retailers buy in small quantities, adding to the shipping and processing costs.
- Governments can impose arbitrary and unexpected tariffs.
- Service, maintenance and follow-on products often are not part of the culture.
- Use of management information technology varies widely. Companies have had to adapt their sales and inventory software to match the IT capabilities or else impose their process on local stores.

In some emerging countries consumers historically shop frequently and are used to traveling short distances. Brand recognition is less important than in developed countries. Stores stock a very limited inventory which means that warehouses must be closer to the retail level. Although shoppers are not “brand-loyal,” they often have store loyalties and return repeatedly to a preferred merchant.

Introducing Multi-brand Retailing

The product mix can be perplexing in emerging markets. At one extreme is the tiny, stand-alone shop that carries a limited supply of products; moreover their inventories change constantly. That is, they sell one brand when it is available, but the subsequent shipment may be a different brand or model. Consumers have little or no selection – based entirely on what is currently on the shelves.

At the other extreme are entrepreneurial regional CE companies that have set up complex relationships with manufacturers, including multiple alliances as distributors and retailers. For example, in the United Arab Emirates, Al-Futtaim Electronics, part of the conglomerate Al-Futtaim Group which operates 40 companies, is the exclusive distributor for Sanyo audio/video products, home and kitchen appliances.



It also handles Toshiba consumer electronics products, including projection TVs, televisions, videocassette recorders, DVD players and home appliances. In addition, Al-Futtaim distributes Alcatel and Panasonic brand mobile phones.

Some products are sold through dedicated Al-Futtaim Electronics showrooms in Dubai and Sharjah and at Al-Futtaim-owned retail subsidiaries and also through a countrywide network of authorized dealers. The parent company owns Plug-Ins Electronix, an expanding retail chain that sells a wide variety of CE devices.⁸

In the same vein, Jumbo Electronics Company Ltd. (LLC), another UAE distributor, operates retail stores throughout the region. Jumbo, founded in 1974, is one of the largest Sony distributors in the world. It also handles products from Apple, LG, Palm, Creative, Dell, Dyson, Epson, Fujitsu Siemens, HP, Hitachi, IBM, Kenwood, Lenovo, Linksys, Microsoft, Motorola, Nokia, Samsung, Siemens, and Toshiba, among others.

Similar integrated relationships are developing in other emerging markets.

Case Studies in Global Retailing

To exemplify the changes that are taking place in global retailing, the following section looks at developments in two diverse regions: China and the United Arab Emirates.

CHINA

The dynamic status of China's CE retailing environment is seen in recent sales statistics. Sales of household appliances, which include CE products, totaled 820 billion yuan (equivalent to \$119.97 billion U.S.) during 2008, up eight percent compared to 2007, but at a lower growth rate.⁹ Retail sales of TVs totaled 124.9 billion yuan, leaping 18.7 percent year on year. Analysts warn about possible difficulties in 2009, based largely on the industry's high export dependency, inefficient capital, and low profitability.¹⁰

In technology, Chinese authorities are trying to encourage domestic formats, rather than being locked into Western systems and standards. The development of the EVD (a potential competitor to the DVD format) as well as government sponsorship of open source computer software technologies including Linux, exemplify such initiatives. Some

western semiconductor companies are supporting the open source plans to assure a stake in the Chinese plan.¹¹

Retailers are adapting to the growth of big box merchants – both domestic and international. Indigenous retailers such as Suning and GOME have expanded their footprints and adopted more employee training programs and customer service offerings.

China's business barriers have changed. Years ago it was just getting into China. Now the challenge is in handling the operational issues, such as licensing, regulatory approval and staffing. Teaming with a local company is not always the best solution since local partners do not necessarily have many commercial business skills. One solution is to set up a company and retain full control via 100 percent ownership, then hire locals and train them to the company's culture and products.

Other challenges include intellectual property theft and privacy (government monitoring of personal and commercial communications via online usage, e-mail and phone). In China, "guanxi" is vital for successful CE distribution and retailing. The term for "connections," guanxi covers a set of mutual obligations between individuals. Once a guanxi relationship is established, either party may make demands on the other without warning or prior discussion. Retail analysts recommend that companies develop such alliances carefully with individuals who have the most extensive guanxi networks.

Major Retailer Initiatives

- Best Buy acquired China's Future Shop in 2001, then bought a majority interest in 145 Jiangsu Five Star electronics stores in 2006, the same year it opened its first Best Buy branded store in Shanghai.¹² The chain now has six stores in Shanghai including its first "digital lifestyle" store in the world. This small (77 square meters) shop focuses only on about 100 kinds of digital products.¹³ Because of current economic conditions, the company says it will slow down its China rollout, but still expects to open several more stores in China in 2009 and 2010.¹⁴ As it has done in North America, Best Buy has begun to focus on services as well as product sales. The company sells extended-service plans, a concept it introduced in China, and which, executives say, has done better than expected. The company's China retail square footage exceeds 1.5



million square meters, compared with roughly 1.4 million square meters at the end of fiscal 2007. Best Buy entered the Chinese market because of its more highly developed supply chain. It is using its China experience to develop strategies for entering India.¹⁵

- Suning Appliance, China's largest CE retailer, plans to open at least 200 new stores across China in 2009, bringing its total number of retail stores in China to more than 1,000. The company also is focusing on after-sale service by adding more than 140 service points to bring its total customer service sites to 260. Suning is expanding its customer service center in Central China, regional customer service departments and city customer service commissioners to improve its service quality.¹⁶
- GOME Electrical Appliances, another large CE and appliance retailer, will close about 100 stores in 2009 due to poor performance. As a result, GOME, which has acquired smaller chains in recent years, expects to maintain its level of 1,300 stores nationwide, while putting more focus on after-sales service.¹⁷
- Wal-Mart operates 227 stores in China, including 121 "supercenters," three Sam's Clubs plus two grocery retailer chains: 101 Trust-Mart stores (which Wal-Mart acquired in 2006) and two "Neighborhood Markets."

Nationwide Home Appliance/CE Subsidy

A new factor that may affect CE sales is a government program to encourage CE sales in outlying regions of the country. China is expanding its subsidy campaign to promote sales of household appliances and CE devices in rural areas, a market totaling about 210 million households. As of February 2009, the subsidy covers computers as well as water heaters and air conditioners. The goal is to improve 900 million rural residents' living standards and boost domestic consumption through a 13 percent subsidy for farmers to purchase household appliances. The program, which began in December 2007 in 14 Chinese provinces and regions, saw a doubling of rural customer's expenditures on household appliances, TV sets and related services.

An economic analysis indicates that the expanded subsidy policy could promote growth of color TV sets by 14 percent. The Ministry of Commerce expects the purchase subsidy

policy could help stimulate rural consumption amounting to 920 billion yuan (\$134 billion U.S.) and drive the sales of 480 million units. An industry analyst predicts that the demand for color TV sets in rural China could reach 100 million units in the coming decade.

During the pilot phase of the rural subsidy program in 2008, customers in Shandong province bought 1.16 million products, including 385,300 color TV sets, 34,300 mobile handsets, 726,400 refrigerators and 13,000 laundry machines. Total sales were 1.7 billion yuan (\$249 million U.S.).

Critics of the subsidy suggest that it mainly covers low-end products and the application process is complicated for some farmers. Supporters hope that the appliance and CE retailing industry will use the subsidy policy to expand rural market sales; they also expect the subsidy program to encourage technology innovation, brand promotion and expanded training.¹⁸

United Arab Emirates (UAE)

The wealthy markets at the southwest end of the Arabian (Persian) Gulf demonstrate the anomalies of the digital era. With government support for planned high-end retail development and encouragement of "destination shopping," the UAE has seen a boom in CE sales. At the same time, independent retailers retain most of the sales in the overall Middle East market.

Sales of consumer electronics and appliances grew by an estimated 30 percent in 2008. The Middle East consumer electronics and technology sector is proving resilient during the global slowdown with retail sales for 2008 totaling an estimated \$37 billion U.S. and expected to reach \$39 billion U.S. in 2009.¹⁹ A study from research firm GfK-MEMRB shows 65 percent of sales are of digital consumer technology products such as notebook and laptop computers, cameras and mobile phones.

Notebooks are popular with UAE consumers, accounting for at least 80 percent of PC sales. Sales of notebooks and accessories reached an estimated \$1.5 billion U.S. in 2008, with CAGR for the 2008-2013 period expected to be in the region of 13 percent.²⁰

The Dubai government supports several annual sales



initiatives, such as the Dubai Shopping Festival, Dubai Summer Surprises and Eid in Dubai, all of which are intended to generate sales (and attract foreign visitors). Major local merchants, such as the Al-Futtaim Group, have supported Dubai Summer Surprises.

UAE has a large number of CE stores – more than 400 according to a recent tally – for a population of less than four million people. *The Dubai City Guide* lists more than 220 electronics retailers – a large number for a city of 1.3 million people ranging from the showcase stores of Bang & Olufsen, Canon, Dell, Harman, Sharp and Sony to regional superstore and specialty chains such as Al-Futtaim Electronics, Jumbo, Jacky's and Grand Stores Digital.²¹

About 85 percent of the UAE's population lives in cities that straddle the country's Arabian/Persian Gulf coastline. The three largest emirates: Abu Dhabi (1.5 million people), Dubai (1.3 million) and Sharjah (800,000), collectively have 84.3 percent of the population. Close to 80 percent of the population are expatriate nationals and nearly 63 percent of the population is male.

Regional retailers are confident about stability and growth in the UAE's CE market.

Jumbo Electronics, a CE and IT distributor, operates a regional chain of 31 stores and nine service centers. The company sees strong sales of computers, digital cameras, MP3 players and flat-panel TV sets. Jumbo is expanding its retail space by 30 percent annually, and now focusing on mall stores.

UAE-based Badri Group has established a chain of electronics retail stores, starting with three "Switch Electronics" stores in Dubai and one each in Abu Dhabi and Sharjah.

Al-Futtaim Group operates under several banners. For example, its Plug-ins Electronix chain is the largest multi-brand electronics and IT retailer in the UAE, selling more than 300 brands.

International companies also are being creative about expanding the UAE presence. In 2008 HP piloted a new 'open force' channel initiative which will now be rolled out across the Middle East. The pilot program, tested in the UAE and Kingdom of Saudi Arabia, offers financial support to large and medium HP retailers to increase the sales force, expand territory and fill skill shortages.

The government's promotion of destination shopping helps Dubai draw customers from India, Iran, Pakistan and many African countries. UAE has also become one of the world's most important logistics hubs, handling U.S. products destined for elsewhere in the region.²²

The UAE is experiencing a retail boom, an offshoot of the housing bonanza. The real estate developers also are creating tourist-attraction shopping centers. For example, the Dubai Mall, a newly-opened upscale shopping, lifestyle and entertainment destination, is among the world's largest shopping centers. It includes an "Electronics Zone" within its Galleria section, clustering local and regional chains as well as international showcase stores.

The variety of retail operations in Dubai include:

- Sharaf DG, Dubai's largest electronics retailer was one of the first electronics dealers at the Dubai Mall. Its "concept store" called Sharaf DG 4U showcase "only the fastest moving electronics and IT products."
- Samsung Experience, the largest store outside of Korea run by Samsung Electronics, opened in the Dubai Mall in late 2008. The 9,140-square-foot store showcases the South Korean manufacturer's products.
- Harman House, the electronics store run by the U.S.-based CE maker, opened its own showroom at Dubai Mall, adding to the prior seven locations in the UAE. The 16,000 square-foot store was the first of 100 outlets the company plans to open worldwide by 2012.

Operating in the UAE

One feature of the UAE's campaign to attract international business is the creation of free zones aimed at technology. For example, the Dubai Digital Oasis, a commercial and residential district within Dubai, has a state-of-the-art IT infrastructure (Wi-Fi coverage, on-site data center, high-speed Internet access, "plug and play" offices), promises "stringent IP laws and support" and offers zero personal and corporate taxation.²³

With all of its wide-open characteristics, the UAE operates under a commercial law process that limits some outside participation. For example, domestic companies must own at least 51 percent in any commercial company. Other legal requirements determine minimal capital contributions, the



number of directors and shareholders and incorporation procedures as well as provisions concerning mergers and dissolution or conversion of companies. Exemptions from the 51 percent law are available in free zones and in some categories where 100 percent foreign ownership is permitted.²⁴

Imports into Dubai can be undertaken only by importers who have the appropriate trade license. Import duties have been largely standardized at four percent, but there are many exemptions.

Despite the government encouragement and aggressive marketplace dynamics, distribution problems persist. For example, Carrefour, the French-owned hypermarket, acknowledges supply chain management problems. Products can fly off the shelves and then not be restocked for months, if ever.

Conclusions

The CE global retail and distribution process is evolving. Not only is there cultural competition between big-box stores and legacy independent shops, but the nature of technology selling is demanding new approaches to sales and support.

Operating in emerging markets requires new ways of assessing and deploying resources, including personnel and locale-specific products. That is why local partnerships are valuable – and often mandatory. Global firms ally with domestic companies that know the intricacies of in-country operations.

The opportunities are so promising that global companies are finding ways to accommodate the differences. ■

FOR MORE INFORMATION:

The March/April issue of CEA's *CE Vision* magazine includes a report on global selling.

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