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Interview with B&Q's Asia CEO Steve Gilman

A couple of weeks before the Chinese government approved Home Depot's US$100 million purchase of a majority share in Tianjin-based HomeWay, China Focus sat down with Steve Gilman, CEO of B&Q's Asian operations to discuss the current status and future outlook of the Do-it-Yourself industry in China.

Here is the second part of the interview.

CF: Whom do you regard as important competitors in your industry? Do you distinguish between Chinese and foreign-invested?

SG: Home Depot will open up very soon. This is the only competitor I am concerned about from a global perspective. They have already done a deal with one of the local providers [Tianjin based Homeway] which is awaiting approval of the Ministry of Commerce. I expect to see it announced some time in the next few weeks.

CF: How many stores will they have through this acquisition?

SG: About ten. This will also give them a quick entry into China, but surely they will have a learning phase with mistakes, just as we did. So, they probably won't become serious competition immediately. In fact, in the short term it might be a real opportunity for us, because integrating the business is a difficult process. They are going to inherit a business, which is doing it a certain way for nearly ten years. When changing the culture, they will need to decide what to change and what not.

CF: How strong have Chinese competitors become?

SG: Much stronger. There are really three groups of competitors we have: The organised home improvement retailers such as Homemart, HomeWay, Orient Home and the Number Nine department store groups. All of these stores are much better than they were five years ago. They have learned a lot, their buying has improved, they have great product ranges and their retail skills are at a pretty reasonable level. Scale and size are very important in retail, especially in terms of buying power. However, some of our competitors such as Homemart are going to become regional rather than national players. This means they should be respected but within their limited activities. Take sourcing: we source from Kunming in the south to Harbin in the north. So, we can choose different products to suit different markets, an option which some competitors may not have. With a size considerably larger than any distributor, we can talk directly with factories, which gives us advantages that we can pass on to our customers.

The second group, which may be bigger competition, are the organised shopping malls. Property companies are building very, very large malls of four to five hundred thousand square feet. Chinese vendors, previously on the street, are now organised and zoned in malls. Because suppliers of similar products, for example bathroom supplies, are grouped, when they display their prices, customers are interested because it makes the prices negotiable. An increasing number of these malls are even offering central invoicing; some of them have the same uniform and well-educated staff. Those are our main competition. However, since some of their prices are substantially lower than ours, I suspect they don't pay VAT.

CF: Considering the usage of centralised invoicing, must they not be paying VAT?

SG: Well, yes and no. What the mall will do is agree with the local authority on a fixed sum of VAT payments for example. Then the mall will pay the VAT lump sum for the year. Technically all small vendors are below the VAT bound. So, they have an unfair advantage. However, since the government needs to increase its tax revenues I expect a normalisation of VAT payments over time. I give them three to seven years. Summing up, those malls are a strong competition.

As a third group you still have the Mom and Pop stores. And they are not paying VAT. I expect them to be around for a long time to come because in a lot of provinces, tradesmen particularly like to deal with direct vendors. China has a multilayer, multi-issue competition.

CF: What made B&Q's dealing in China so successful?

SG: First of all, I think we entered at a fantastic time. It was Geoff Mulcahy's vision, our CEO at that time, who had the vision to get into China in the late 90s. I think he pitched it just about perfect, and we got in just as the market was opening up, when retail was an experimental industry. It meant we were able to learn and make all the mistakes before we had the full spotlight on us as it is today. It also meant we placed ourselves in a good position in terms of location of stores. The prices we paid for stores in key cities like Shanghai and Beijing were still reasonable. This early move really enabled us to do better. Nevertheless, early market entry is right, but there are probably three stages. In the first stage it is “forget it”, in the second it is the absolute right time to go and in the third you are already a bit late. Geoff picked it right almost to one year. We opened our first store in mid '99, arguably mid '98 would have been better. But we were working on that from mid '97 into '98 and then a bit into '99. Hindsight is a wonderful thing, but we were certainly within 6 months of were we should have been. Currently, I am looking at India, which is somewhere in between the first two stages and I expect there is still some time to go for India.

CF: In 2005 B&Q acquired the 13 stores of the German D-I-Y chain OBI in China. What were the main differences between B&Q and OBI at that time?

SG: OBI made the decision to enter China broadly at the same time as B&Q. And actually OBI started slightly before us and opened their first store in Wuxi before we did. Call it instinct or intuition or whatever, but from day one I always thought one day we might buy OBI. So, I deliberately didn’t open stores very close to OBI's. Don’t ask me why, I just thought one day we might buy OBI. We continued opening our stores and when the opportunity came, it was almost as if it was preordained.

What OBI was doing, from the day they entered to the day they closed, was building very large stores in European tradition. The same stores you will see anywhere in Germany, in Poland or Russia. Very large stores with very large garden centres, consequently with high costs of air conditioning. They were importing all their racking and shop fittings from Germany. They never localised any of that and in the early days they had something like 20 to 30 Germans working in each store.

CF: In one store?

SG: Yes, I did the same thing for store one, but by the time I came to store two, I was localising most of it. All our outfit was local. We were using decking and racking manufactured in China made at ISO Standard. We arranged two shop fitting companies, one Chinese and one Taiwanese. In addition, we didn’t build big garden centres, because we knew that most of the consumers didn’t have big gardens. We never air-conditioned our warehouses because we knew we had to keep the power costs down.

We entered China with a 'Chinglish' version very early on. We understood we have to work on a very low cost basis, whereas OBI was quite often really beautiful with really nice blazing, fantastic lights. I would have liked to do that, but that would put my cost out of control. Instead, we chose to build our stores functionally correct, attractive enough to make them look international, but without frills.

CF: Have you encountered significant differences in terms of locations between OBI and B&Q stores?

SG: OBI broadly went into the market with 40-year land-use rights for most of their stores. We applied the 80:20 rule from day one. This means that 20 percent of our stores are land-use rights, the majority are leasehold. By this, we actually invested less capital from day one. This results in a clear difference in terms of cost of occupancy. We were looking for ways to get the cost of occupancy down. Combining our retail surface with appartment houses on top is one approach. It makes no difference to my retail environment, but I can do a better deal because the developer gets a better top ratio return compared to a stand-alone. Virtually all the OBIs are stand-alone, only a couple are actually in malls and we are in the process of changing that now. Doing stand-alone stores on a 40-year land use site drives up your costs of occupancy. Apparently, OBI's costs were much higher per square metre than B&Q's costs were from day one.

CF: How important were people for this development?

SG: Very important. OBI chose Dr. Li Fengjiang to lead their operations. Dr. Li, whom I always admired, was quite European in his management. And from the start, the vast majority of OBI's management was German. This team worked for OBI for a number of years and they were developing their stores as OBI always developed their stores everywhere, from day one and until today. I always had the majority of my management team made up of mainland Chinese. Of course, we are using expatriates, we have a few foreign-educated Chinese in there, but the majority are mainland Chinese – because we always built the business as a Chinese business. We had people that intuitively were making the right decisions from day one and teaching the expats how to do it.

OBI instead became very close to Haier when they decided to partner up with them. After this, there was a stage where all the Germans left. Suddenly, it was all Chinese and the standards, which were European became very Chinese. A while later, they brought all the Germans back in again. On the other hand, we started with a mixed team with the majority of mainland Chinese in the management team. We never had more than six or seven expatriates in China. At one stage, I think OBI had about 25 to 30. In our approach, we always developed the business for Chinese people by Chinese people, supported by expatriates.

Another differentiator were products. For example, OBI stores offered a complete range of sit-on lawnmowers with very big petrol motors. If you are rich in China you don't buy a lawnmower yourself. You have a gardener and the gardener will buy the lawnmower. Hence, those are trade markets as opposed to consumer markets. OBI also had Scandinavian log cabins in their garden centres with built-in saunas. There are probably a few potential buyers out there but they are at the very, very top end of the food chain. The price of these cabins was equivalent to five to seven times the average middle class Chinese income, thus you can't sell many of them. Indeed, OBI stores did look much more European and in some ways more attractive than a B&Q store. They positioned their stores at the very top end. But functionally, all the fancy fitting just sat there and did nothing.

CF: Where did OBI have advantages?

Naturally, they did some things better than we did. One would be their hand tool range. OBI almost exclusively used the German brand Lux Tools and they started to localise more and more of the tools with very good quality. The Chinese have a thing for products from Germany. If products are German, they are believed to be functionally accurate, very precise, strong and well engineered. We started buying from about 30 vendors for our tool range. As a result, we kept Lux Tools and will offer the Lux range of hand tools in all our stores soon.

Summing up, we tried to keep all the good things that OBI did, as well as all the things we are doing. And we got over 2,000 people out of this deal. And virtually all of them stayed.

CF: How did you manage to retain the staff?

SG: We did quite a bit of cultural work, because we knew the OBI guys had done it differently. Training is a key lever in all retention programmes. Training programmes at the appropriate level for all employees are paramount. At the top end, we are putting a group of people through INSEAD. Another retention driver is bonus payments for the top 70 - 80 people. This is a long-term retention bonus, which means if they stay with us for a reasonable number of years, they can take out a large amount of the money. We paid our first retention bonus out at the beginning of last year and out of the top 74 people we lost two. Measures to retain staff should be a mix, a bit like a cocktail. And I think that is why we hold on to people and we attract people in the first place. Pay is important, but it isn't everything.

CF: What is your outlook for the next five years for B&Q?

SG: We went from 21 stores at the beginning of 2005 to 48 by the end of the year. We owned 21 and acquired 13 from OBI and opened the rest during that year. That was an enormous year. We completed all acquisition integration including the head office. This gave us larger scale and lots of learning. And we are still putting things back into the chain now. If we carry on we will have 58 at the end of 2006. We are planning to open ten more next year, 68, and maybe ten more the year after. So, at the end of 2008 we hope to have something like 78 to 80. The five year plan is to have 100. I'm hoping at the end of 2010 we will have

100 stores. My first goal was 50, the next goal is 100. I think the growth of the Chinese economy will continue. And I think if you look at the last three centuries arguably you could say the 19th century was Britain's century, the 20th century was America's century, and this century is China's.

Personally, I think China will continue to be a very important part of my life, because my son is going to end up doing most of his career down here. He is learning Chinese and speaks it a lot better then I do. I am sure I will always have links down here. I love this area and I really find it fascinating to be a part of the China development.

CF: Thank you for this interview.