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Kingfisher Attacks the China Market

Abstract This article examines the entry to the Chinese market of Kingfisher plc under its B&Q brand, operating in the DIY or home improvement market. It is a pedagogically oriented case in the international strategy area, which deals with both the mode of market development by the company in China and some of the softer issues arising from that process relating to HR in the company and the inevitable cultural challenges it faced. The story begins in the mid-1990s and goes through to the early summer of 2010. On the one hand, the entry has been successful: B&Q is now a significant presence in China, holding number one position in their chosen market, which is primarily highly fragmented; there is some concentration in four key cities in the wealthy east coast region; and it has made profits over a fair portion over the last decade. Lessons were learned from the initial mistakes and the core sales proposition in China has been crafted to differ from that in the original UK home base. However, for the last three completed financial years, losses have been booked and significant changes have been made or were planned at the time of writing. Some changes were inevitable, but which were they (other than those where the Chinese government changed its rules)?

Keywords Multinational Corporation (MNC), retailing, do-it-yourself (DIY), China, regulation, market development

1 Introduction

Kingfisher is a British company (in the FTSE 100) in the do-it-yourself (DIY)

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and building materials supply business, sometimes called the home improvement market, aping the Americans. Its primary base is in the UK, i.e., its home market, although by the time of writing it also has established overseas operations in France, a large scale operation, and lesser projects in Poland, Italy, Turkey, Spain, Russia, Eire and China.

Table 1 shows how the China subsidiary fits into the wider group.

Table 1 Kingfisher’s China Subsidiary in the Group Context

Year ending January	2008		2009		2010	
	Group	China	Group	China	Group	China
Revenue/Sales (£m)	9,050	565	10,026	431 [restated at 499.4 in 2010]	10,503	444
Operational profit/loss (£m)	428	(27)	446	(52) [restated at (60) in 2010]	606	(34)
Profit for Year (£m)	272	—	294	—	375	—
Number of Stores	780	63	823	63	831	43
Employees (FTEs)	71,238	10,358	67,726	10,030	64,576	7,161
Revenue/store (£k)	11,602	8,968	12,182	7,927	12,639	10,326
Revenue/person (£k)	127.0	54.6	148.0	49.8	162.6	62.0

Source: Created using data from Kingfisher’s *Annual Reports* 2008, 2009 and 2010.

By early 2008, the 2007/8 loss notwithstanding, the B&Q (China) picture was probably seen by the world outside as quite a positive one. It reflected a situation wherein a foreign, British, company had successfully entered China and built up a non-trivial position which made it the market leader in its particular niche.

A year later in March 2009, Kingfisher announced in its 2008/9 Annual Report that its Chinese subsidiary had problems. The review by the new Chief Executive, Ian Cheshire, stated that significant corrective action was required in B&Q (China) but that in the medium term the parent remained confident of a return to trading profitability delivering long term benefit to the group, but with the first year in which a full year profit would be recorded being 2011. Some key factors and actions were noted to include a plan to further reduce the number of stores from 63 to 41 (one had already been closed) with 17 of the 41 experiencing major reductions in scale. It was claimed that sales had fallen in 2008/9 (see Table 1), leading to a loss of £52m, including an exceptional item of £107m to reflect the costs of the restructuring now required, £33m of which was for clearance of surplus stock.

By the annual meeting in June, 2010, store numbers in China were reported at 43, with 7,161 full-time employees, generating sales of £444m, “primarily reflecting 20 fewer net stores [now] trading compared to the prior year.” (Annual Report 2010: 21). The efforts had been such that they were reported to have delivered “a positive free cash flow in year” (p. 2), helped by “working capital reduction in line with target,” [this latter point being in large measure due to an aggressive purge of slow stock in stores.]

There are essentially three questions which the case explores. Did the initial B&Q (China) management team really get its plans badly wrong? Or had the market fundamentally changed or was there a combination of the two? Were the changes imposed from London in 2009-10 appropriate? The following sections consider: B&Q (China)’s evolution in its first ten years; the ingredients of its initial success; some of the problems encountered even while building that initial success; the changes proposed by London in response to declared losses from 2007; and some final thoughts.

2 The History of B&Q’s Evolution in China

This historical review initially relies heavily on Kingfisher documents to paint the background of the story. B&Q opened its first store in China in the Hutai area of Shanghai in 1999, two years after appointing a General Manager charged with establishing B&Q in China. 1999 was also the year in which B&Q entered into a joint venture (JV) with a local company called Home-Dec, the shares (65%, 35%) being the larger being owned by B&Q. Home-Dec was itself a three handed partnership between Shanghai Gas, Shanghai Gas Meter & Appliance and a Baoshan property developer. This JV deal was crucial in that an early decision had been to open first in Shanghai; Home-Dec owned a piece of land in Shanghai; and, pre-WTO entry, a JV mode was inevitable for a foreign invested entity (FIE) entering the Chinese retail sector.

Table 1 below summarises the history line from 1997 to 2007, as set out by B&Q in a presentation made in Shanghai in January, 2008.

The Kingfisher *Annual Reports* (2008, 2009) confirm that by June 2008, Steve Gilman, the CEO of the then intermediate holding company B&Q (Asia) had retired, slightly earlier than expected in the wake of Gerry Murphy’s demise as CEO of Kingfisher, with effect from February 2008.

Further changes in both “overstructure” and CEO for the Chinese company were made by early 2010, Annual Report (2010). The architecture with an Asian

holding company had been removed, with the Chinese subsidiary, incorporated in the Netherlands reporting directly to an International Director in London, Peter Hogsted, a member of the Kingfisher Executive Group but not a Board member. Gliwinski had moved on and the new CEO of B&Q (China) was Loïc Dubois, a sometime employee of Carrefour in Asia. It is interesting to note that this new boss for the China company was hired under the aegis of former Carrefour CEO, Daniel Bernard, who moved into the Chairman’s seat at Kingfisher in June 2009.

Table 1 B&Q (China): History to 2007

1997: GM appointed to establish B&Q in China. Shanghai selected as first entry city.
1999: JV established. First store opened in Hutan
2000: 2 nd store opened in Shanghai. Decoration Service launched.
2001: First store outside Shanghai in Suzhou. First two-floor format shop opened in Shanghai’s Yang Pu district. First store in the west of China—Kunming. SAP implemented and Training Centre launched
2002: Ranked No. 1 by China Retail Association. Regional (intra PRC) offices established. B2B Trade launched. Profitable before pre-opening costs.
2003: Turnover doubles; B&Q becomes a truly national Home Improvement retailer with openings in Beijing and Guangzhou. Business profitable after pre-opening costs.
2004: Strengthened market leader position. Retail profit 2004 = 10 × profit (2003). (Post WTO) retail became a deregulated business area in PRC on 11 th Dec allowing WFOEs (wholly foreign owned enterprises). B&Q set in train process to buy out its local partners in Shanghai.
2005: B&Q grows by buying out OBI (a significant competitor), acquiring 13 stores. Opened 14 new outlets; total store number reaches 48. Retail profit almost doubles compared with 2004. OBI stores successfully integrated, meeting initial synergy targets.*
2006: Ten more stores opened, making total 58; Turnover reached 6.6 billion yuan.
2007: Another five stores opened, making 63 in total (including 1 in Hong Kong)

* although this might be thought to be a slight overstatement in terms of issues identified by Steve Gilman, CEO (Asia) to 2008, including OBI having set goods standard/quality pitch wrong for local market, lack of a decoration service and inclusion of some wholly inappropriate lines such as Alpine saunas.

Source: Adapted from B&Q (China) Company presentation 22.i.2008: italics due to the authors.

When the first store opened in Shanghai in 1999, it was a 65:35 JV, in partnership with Home-Dec. As noted, it had to be a JV because Chinese business law then required such for retail ventures with foreign participation.

Retailing came in what was known as the ‘restricted’ category for FIEs (see Lauffs and Tan (2002) for more details). Such restrictions were required to cease by the end of 2004 as part of the conditions for access to the WTO in December 2001, Lauffs and Tan (2002).

The traditional phrase in Britain to describe B&Q’s type of business is DIY, although the phrase DFM (do it for me) is now coming into use as such firms offer allied contracting services. Some writers, e.g., Wu (2008), when talking about this issue in China also talk of CIY—create it yourself, in the sense of designing and/or specifying what the project will look like when finished—and BIY, buy it yourself.

3 The Ingredients of an Initial Success

Mapping the distribution of B&Q’s stores in 2008 reveals two key patterns. First, all were located in tier one or tier two cities. Second, 51 of the 63 stores were located in the rich, eastern coastal region—the outliers being in Harbin (1), Changchun (1), Shenyang (2), Xi’an (2), Chengdu (2), Chongqing (3), and Kunming (1). Market share showed market leadership nationally and in each of the important “core cities” of Beijing, Shanghai, Guangzhou and Shenzhen (“South China’s Hong Kong”). Nevertheless, having some stores as singletons or pairs in tier 2 cities, away from the eastern coastal region meant inevitably stretched supply lines in a geographically spread country such as China—Kunming, in Yunnan Province, is over 1,200 miles from Shanghai, while Harbin the capital of Heilongjiang, lies about 660 miles from Beijing and over 1000 miles from Shanghai.

The basic structure of the market development was one of concentrating on the major eastern cities, starting from Shanghai, and focussing on tier 1 and then some tier 2 cities, reflecting the pattern of expected demand for the new concept in China of do-it-yourself-in-some-part (DIY-ISP). This in turn was allied to the new wave of home ownership as the economic gains of the Opening Up policy took hold sufficiently to enable enough middle class families to make use of such a service. Prior to this, the DIY market was a fragmented local small firm. With a population of almost 1,200 million in the mid 1990s, one might estimate the economically capable middle class to be between 100m and 300m, dependent on the chosen, defining parameters. That in turn might deliver 50 to 150 million home units which might want to play a part in their homes’ fitting out, refurbishment or decoration and most of them would be found in the richer areas

within the major cities. Gliwinski (2007) noted, “The rule of thumb is that you normally need a population of 2 million to justify a store [in China], certainly 1 million, even if you have a more affluent city area. So if 10 percent have the required disposable income to participate in or buy from our type of business, the 1 to 2 million translates into a store catchment market of 100,000 to 200,000.” Thus a core store in a tier one city might be of 160,000 square feet, while those in tier two cities would tend to be smaller, at around 70–80 thousand square feet. Therefore, for example, he estimated Chongqing might justify 3 or 4 stores of the smaller size “to serve its 8 million population.”¹

During the initial growth phase, Gilman and his Chinese CEO in B&Q chose partners perceived to have business interests fairly well aligned with their own, which contrasted with US giant Wal-Mart’s policy of using investment companies only, see Tseng and Foster (2006). B&Q changed to a more investment partner path before WFOEs became fully available for FIEs, after full WTO deregulation by 2005. Over the same period, US competitor Home Depot chose to follow Wal-Mart’s approach.

Gliwinski (2007) noted that, once post-WTO freedoms were available, all the most recent and planned new store openings were on a WFOE basis but B&Q were not rushing to try to buy out all their JV partners, many of whom were state-owned enterprises (SOEs). Some of the partners had been good partners and were therefore encouraged to participate actively in their JVs, others were less good and then the option to buy them out would be pursued provided a reasonable consideration could be agreed. It should be remembered, Gliwinski stated, that even when they operated in JV mode B&Q (China) always had managerial control.

Regarding the DIY-ISP issue, the key issue for B&Q in China was the way in which houses and flats are sold and what buyers of DIY products could imagine themselves doing. Most new-build flats are sold in a “bare wall” format and it is expected that the purchaser will commission the fitting out, typically using local, jobbing builders. The typical Chinese, middle class, flat-buyer would not buy the tools and materials to do the work themselves. Through the 10-year initial growth phase, most commentators assumed that B&Q would rely heavily on the new build market: In 2007, the company reckoned the proportion of its business from

¹ Citing this population as 8 million is interesting of itself. The issue being raised by B&Q management was this: The official population of Chongqing (as per the Chinese Statistical Yearbook say) might be given as 20 million but in reality the population of the core city is only 8 million or whatever—20 million is the so-called municipality’s population.

this source was at least 40 percent.² Post 2006, this market slowed sharply as China paused, relatively, along with the rest of the global economy

Up to 2008, one key difference in B&Q's Chinese outlets compared with the parent was the presence of franchise counters inside the store, manned by franchise employees, a practice typical of retail outlets for other types of merchandise in Asia. The potential problem is quality maintenance if a franchise does not share the same aspirations as the host retailer. Gliwinski (2007) said that a value-for-money (VFM) proposition based on both quality and trust was his pitch for B&Q (China). They were not the cheapest in their market but, working to guarantee quality control meant delivered quality for the customer, which then delivered VFM. In short, the business strategy pitch is one of differentiation, constrained by cost management. Another difference, in product mix this time, sees more home appliances such as air conditioning units but an absence of the gardening sections which are a major component of many of the UK stores now.

A key issue for any company investing abroad is who to have on the payroll of the FIE: especially the expat-local mix in management (see Hutton, 1998). At the subsidiary's inception, B&Q hired two local Chinese with overseas passports, one of whom, David Wei, became the President (or CEO) of the China subsidiary. After his departure, Wei was described affirmatively by his successor as President, Gliwinski, as "good at setting up new operations, making the initial breach in 'barrier walls.'" For his part, Gilman (2008) reported in that he had always seen the merit of using local Chinese as front men for certain aspects of business development such as tying up land deals, since using foreigners could immediately raise the price expectations of local land agents.

Gilman (2008) and Gliwinski (2007) both subscribed to the philosophy that a multinational company in China like Kingfisher should push as many locals as possible into the chain of management, subject to availability of competent managers. In June 2007, B&Q (China) had just 6 expatriates on its payroll, three at local board level including the President, and three specialists at a lower level, one in each of Finance, Property and Buying. Gliwinski (2007) noted that recruiting good managers in China was much harder than sourcing workers.

On the issue of pay packages, the target was the upper quartile for its sector for management and the second quartile for international retailers for workers. In

² While this assumption was valid at the time, mature reflection surely causes one to speculate that sooner or later the refurbishment of second hand flats would surely take a more prominent place.

2008, the award pattern was about a 6 percent rise and a 10 percent bonus for the rank and file. For management, there was a retention bonus scheme for some 80 key people, about 0.7 percent of the total workforce of 12,000 (in headcount terms). There were then another 350 in lesser, management grades. The retention bonus indicates a recurring problem in China, viz high staff turnover rates as those with some ability seek to climb the remuneration ladder as fast as possible. Even at the depths of the global downturn in 2008–2009, China’s growth rate did not fall like those of the developed economies. As a result, mobility of labour was a possibility certainly for PRC employees who were both educated and experienced. The situation was much tougher for ill-educated, unskilled labour across China as SOEs shed labour to try to become efficient.

4 Some More Problematic Aspects of the Initial Phase

Steve Gilman stated candidly in 2008 that, like most new ventures in any country, B&Q had made mistakes. There had been errors in the product range and store layout: For example, the inclusion of electrical goods in the offered range because Chinese dare not touch anything electrical in their flats; and wallpaper which sells poorly in China. Initially, the store layout was based on functionality and/or quality, not brands, but they found Chinese tradesmen are brand loyal.

Shrinkage, mainly theft, as in all retailing was found to be present. Gilman (2008) estimated possible breakdown as: customers 30 percent, staff another 30 percent, and another 40 percent, including suppliers (the “short” delivery), whose cause was not known because of poor administration. The relatively low customer proportion may be a result of the high density of staff on the sales floor, while the last category should be capable of reduction by improving the admin. One interesting aspect of Chinese law is that staff proved to have stolen can be required to make restitution, even after being sacked.

B&Q’s takeover of OBI’s China subsidiary in 2005 gave B&Q about one third more stores—the total number reached 48 by the year end including the 13 OBI stores. In market share/presence terms, the deal clearly had merit but it also brought problems. B&Q had developed its own business and made money in the early years by operating with a low cost base, including much lower property costs than in UK, with lower cost shop fittings delivering an “acceptable” image by Chinese standards. Things had been different at OBI. All land leases were handled by expatriate Germans and the resulting leases were expensive. Their

stores sat at the top end of the (European) property quality scale including all imported shop fittings and steel. There were product range gaffes including greenhouses and Alpine sauna units and OBI offered no decoration service. It is claimed that OBI started with 28 Germans in China. All of this suggests a high cost base. B&Q run an “expert” function in Hong Kong for Finance and HRM.

Gilman (2008) elaborated that there were problems but not insuperable ones; the financial performance and related issues were as follows:

Years ending 2003, 2004, 2005 and 2006 B&Q (China) showed a trading profit after store opening costs using UK accounting policies. 2007 saw the onset of problems, with negative results for the P&L account: These included lack of like for like sales growth; new stores did not yield the results hoped for and/or were late opening; problems emerged with vendor buying agreements (VBAs).

97% of their suppliers had signed an agreed VBA which the Chinese government agreed were legal but stated were “not in an appropriate spirit.” About 7 or 8 out of a total of 1,300 suppliers (less than 1%) started to “cause mayhem.”

Regulation 17 promulgated by the Ministry of Commerce (MOFCOM)³ meant a considerable loss of rebates, hitting the profit of companies such as B&Q.

A soft deal on VAT rebates (up to 17.5%), locale by locale, had been terminated but local deals in smaller amounts were still not out of the question.

³ Regulation 17 refers to an “Order of Ministry of Commerce, National Development and Reform Condition, Ministry of Public Security, State Administration of Taxation, State Administration for Industry and Commerce, Measure for the Administration of Fair Dealing of Retailer and Supplier,” promulgated by the MOFCOM on its website on October 18th, 2006. The untutored reader may find it difficult to see where the sting is in these provisions for retailers but, like so much to do with the law in China, the answer may lie in “interpretation.” One interesting aspect, given what followed at B&Q, lies in Article 8 which states, “Retailers may not require suppliers to dispatch personnel to provide service at the business unless the following circumstances [apply]:...” In essence they should only sell/service their own goods, or agree a pre-determined set of duties for which the retailer will pay the supplier.

There had been restructuring costs around the OBI acquisition, and some need for stock clearance. Given that, he speculated that the subsidiary might be back into the black in 2008 but failing that in 2009.

The “rolling out” of Trades Unions to represent the workers in the business, which would be required of them, during 2008, would add 1% to costs.

For the longer term, retail planning law had been tightened up. Hence there would be no more slash/burn/clear sites and hand over “free” to a developer. Another impact would come from a new limit on store sizes within ring roads of major cities. The likely consequence would be development of smaller stores: This particular rule was designed to make more change for the big food stores.

Returning briefly to the VBAs, the trouble emanated from around the time of the Lunar New Year in 2007 from kitchen supplies vendors, but it was whispered to us by “other sources,” that it probably came directly from government with the suppliers used as pawns. Initial complaints led to demonstrations and blogs. When B&Q (China) asked the MOFCOM in Shanghai and Beijing what one should do, the advice was to “employ a learned Professor who would be able to transmit an accurate feel for how the [in fact legal] VBAs should be changed to become ‘in the right spirit.’” This is a prime example of what Tseng and Foster (2006) called their seventh force, the lightning strike from Beijing man.

Finally, on sourcing of materials from China, McKinsey Quarterly (2006, p91) quotes Gilman as stating that 96 percent of the goods sold in their China stores were also manufactured there. Up to 2008, this China sourcing was booked through Kingfisher Sourcing, a subsidiary of Kingfisher (Asia) Ltd, headquartered in Hong Kong.

5 Kingfisher HQ Announces It is All Much Worse

As noted earlier, Kingfisher announced booked losses in their Chinese subsidiary in Financial Years ended January 2008, 2009, and 2010. In the accompanying report for the year ending 2008, an exceptional charge of £22m was announced reflecting “an accelerated write down in assets” (p16), with a possible further charge of £11m in 2009. In 2009, a further exceptional charge of £107m was made and Hogsted was quoted in the *Annual Report* as saying (p. 8), “a comprehensive China repositioning is now under way, store numbers will be

rationalised from 63 to 41 and all remaining stores will be revamped, of which 17 will be downsized. The product and service offer will be updated ...”

At the Kingfisher annual meeting on June 3rd, 2009, retiring Chairman, Peter Jackson said, “We lost direction in China in the way we were selling our product, ... but we decided not to cut and run; that wouldn’t have delivered any value for shareholders,” and he continued, “maybe our offering wasn’t right for the changing market.” It was suggested that it would serve the firm better to cluster where they were already strong, compared to opening single stores in tier 2/3 cities. The property value (the value of long term, say 40 year, leases since all land is state owned) was claimed to be around £300m so there was a potential exit value if desired.

In a short conversation with Cheshire after the meeting, he said, “it was really a coming together of three factors at about the same time which led to the “stress” in China.” These were:

- The effect of regulation 17, with the impact for B&Q because they were sub-letting space and taking a well-head royalty; and some of the suppliers in-store cheated, displayed and took orders in B&Q and then sold direct round the corner;
- An overdependence on new flat fitting, which he claimed had grown to 50% of their business; this hit hard when the Chinese government put the brakes on property selling; and,
- The general economic slowdown hit consumer spending.

Following on from Jackson’s remarks, he highlighted the new strategy: a target of 75:25 or at worst 70:30 mix of pure retail to new home fitting business; smaller stores generally; and focus on tier 1 cities, with consequent development of clusters. Another part of the change was a move away from the staff localisation policy, supported by Gilman (2008), to one with an expatriate CEO in China and a significant number of other European managers. Was such a move wise? There is definitely a view in the literature against as well as that in favour of using expatriates, see Hutton (1988, Chapter 6). The whole mix now reports to Hogsted in London albeit he is “on the plane to China frequently,” according to Cheshire, rather than operating under an Asian HQ based in Hong Kong.

In 2010, *Annual Report*, Hogsted reported good progress with the “turnaround” plan and highlighted the hiring of Dubois as President of the China subsidiary; and (on p2) replacement of supplier-funded reps in store by B&Q trained staff in most product areas; and, launch of “a new, single room make-over and single

product installation.”

6 Final Thoughts

The appropriateness of the changes initiated from London in 2009–2010 could potentially be mixed. Some of the moves seemed sensible. For example, the smaller stores format could be seen, looking forward, as an inevitable result of regulatory change by the Chinese government, while managing the home-fitting/general business mix can be seen as a prudent risk-reduction measure. However, neither are really criticisms of the pre-2009 management. On the other hand, the move to a more expatriate focussed management for the China subsidiary could be viewed as much more contentious. As noted before, there are two very different views of what may be appropriate manning policies in overseas subsidiaries of MNCs. Whether London is “right” might depend in part on how attuned to the Chinese mind their “new” foreigners are, especially the CEO for China, Dubois, according to Selmer (2004). Another strategic issue and change determining the strategy, was the exclusive focus on tier 1 cities: Only time will show which approach is right but it is interesting to note that this focus differs sharply from that of UK retail giant, Tesco(see Foster and Noh, 2010).

Finally, there is an interesting question about which one might speculate but one not really answerable from outside the company. Namely, how much of the booked write-downs (in 2008–10) were unavoidable, or had Kingfisher padded the losses for tax reasons?

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