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With a little help from my friends: Multinational retailers and China's consumer market penetration

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ABSTRACT

We investigate the supply-side repercussions on Chinese imports after the entry of multinational retailers in China. We exploit sector- and origin-country level import data for a panel of Chinese cities between 1997 and 2012, and differentiate between retailer and non retailer goods and across countries of origin of imports. We find that international global retail presence in Chinese cities produces a disproportionate rise in retail good imports from the retailers' country of origin. Our results point to a trade-cost reducing role of Western retailers that make it easier for foreign retail-good producers from their home country to export to China. Global retailers then act as a bridgehead for the penetration of the Chinese market by producers from their home country, in a way that goes beyond higher sales of imported retail goods by the retailers themselves.

1. Introduction

China is in the midst of an economic makeover aimed at rebalancing its economy through the increase of private domestic consumption. Consumption is replacing investment as China's main engine of economic growth, creating significant opportunities in the retail market. China overtook the United States in 2011 to become the world's largest market for grocery shopping. Penetrating the highly profitable and rapidly growing Chinese retail market is now even more the key objective for most Western producers and retailers.

Multinational hypermarkets were established only recently in China, but have developed very quickly. The number of foreign grocery retailers outlets in the Chinese market went from zero in 1995 to 126 in 2000 and reached 2516 in 2014 (Planet Retail, 2014). The extent to which this expansion has helped producers from the retailers' home country to penetrate the Chinese consumer market is however unclear. Foreign retailers in China mainly propose locally-sourced products: 90% and 95% of the products offered in Chinese Carrefour and Walmart stores respectively are produced in China (Moreau, 2008). In contrast to the well-studied case of Mexico (Durand, 2007), foreign retailers in China may not bring significant imports from their home country with them.

We here investigate the extent to which foreign global retailers can nevertheless act as bridgehead for the penetration of the Chinese market by their home exporters. Our empirical analysis relies on sector-country level import data for 287 cities over the 1997–2012 period.[1] We consider the five leading foreign grocery retailers in China (Auchan, Carrefour, Metro, Tesco and Walmart)[2] and use a difference-in-differences specification. We rely on differences in the expected impact of international retailer presence between retailer and non-retailer goods to isolate a causal effect on imports. We furthermore investigate whether international global retail presence in

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[1] China is divided into four municipalities (Beijing, Tianjin, Shanghai and Chongqing) and 27 provinces which are further divided into prefectures. As is common in the literature, we use the terms city and prefecture interchangeably, even though prefectures include both an urban and a rural part.

[2] We started with the ranking of global retailers provided by Deloitte in 2009 (http://www.deloitte.com), which lists the major global retailers by countries of operation. We looked at the top 20 retailers and identified six with operations in China. We excluded Home Depot, which ranked fifth, from our analysis as it is a specialist retailer, in contrast to the other five chains, and because it did not enter China until 2006 (Head et al., 2014).

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Chinese cities produces a disproportionate rise in imports from the retailers' country of origin.

This paper contributes to the emerging literature on the economic implications in the home and host countries of overseas retail expansion. Most of the existing literature has focused on the impact of global retail on the host countries' economic performance. A first effect is local firm productivity: global retail chain entry has been shown to fuel productivity improvements in supplier firms in Romania (Javorcik and Li, 2013) and Mexico (Iacovone et al., 2015; Javorcik et al., 2008). A second channel is exports from the host economy: increased exposure to multinational retailers raises exports by enhancing the general export capabilities of the location (Head et al., 2014). In contrast, we here investigate whether the presence of multinational retailers affects host location imports, and thus consider additional ways in which retailers influence international trade. More specifically, one of our questions is whether international expansion by retailers contributes to their home countries' export competitiveness.

Our paper relates to the work on the importance of imports for retailers (Raff and Schmitt, 2015). Evidence from direct import activities by US retailers stresses that larger retail firms tend to import more, and that retailers are especially active in importing low-value products, predominantly from China (Bernard et al., 2010a). Basker et al. (2010b) go beyond direct imports and identify a positive link between the growth of large retailers and that of imports of consumer goods across US sectors.[3] They show that the largest retail chains have a much greater propensity than smaller retailers to import from less-developed countries, first and foremost China, and that their greater sourcing of cheap (durable and semi-durable) products (especially from China) helps these large chain retailers dominate local retail markets. Our focus here is different since we look at Western retail presence in China, the country from which hypermarkets typically source a large share of their non-food products. In the specific context of China, the opening of Western hypermarkets is less likely to result in greater imports of non-food consumer products to be displayed on its shelves. China is hence a very good setting to identify more indirect channels through which multinational retailers contribute to the international opening of the domestic consumer market.

Our work hence contributes to the recent empirical evidence on the positive effects of a country's overseas retail presence on its exports to those markets. Cheptea et al. (2015a) consider bilateral agri-food exports for a large panel of countries over the 2000–2010 decade and find that higher sales by a retailer in a country are associated with more imports by that country from the retailer's home country. Two broad mechanisms can be at play here. First, the establishment or extension of operations abroad by a retailer from a given country reduces the export costs of the home-country firms exporting to these markets. Multinational retailers may continue to work with their domestic suppliers in their international operations. In addition, their foreign activities may generate informational externalities that benefit home-country exporters. Second, multinational retailers may influence consumer demand and give rise to new consumption behaviors. More generally, they can improve the global image of their home country among the population they serve and generate greater demand for goods (not only retail) originating from their home country. Our analysis aims to clean out the latter channel pertaining to demand and preferences and focuses on the supply side, whereby the expansion of multinational-retailer activities in China reduces the trade costs foreign producers face to export to China, and so boosts their exports to China.

Focusing on a single country like China, instead of an international panel of countries, is relevant for a number of reasons. First, the country's opening to multinational retail chains is recent, so that our analysis covers the emergence from scratch of the now largest retail market in the world. Second, using cross-regional data from a single country, instead of cross-country data, mitigates data-compatibility problems that are typical in cross-country regressions. Third, the large size of the country and the differences in entry timing of multinational retailers across cities provide substantial variation that we exploit to identify the causal effect of the presence of multinational retailers on imports.

Our analysis builds on recent efforts to address the problem of the endogenous location of multinational retailers. It seems likely that the timing and specific location choice of the opening of foreign hypermarkets in China were correlated with various broader economic variables, as well as specific ties with retailers' origin countries which likely affect import propensity. Foreign retailers clearly opened their first stores in well-developed regions, such as the Eastern metropolis of Shanghai, the busy port of Shenzhen or the capital Beijing. Another problem comes from reverse causality: greater trade openness affects the structure of the retail industry. Two recent theoretical models suggest that trade liberalization is associated with greater market concentration in retailing, so that large-scale and cost-effective chain retailers expand (Basker and Van, 2010a; Raff and Schmitt, 2012). We then risk over-estimating the positive effects that hypermarket opening have on imports.

Our main strategy to deal with endogeneity exploits variations in the expected impact of the opening of global retail chains by product categories and import origin. We hence consider the differences in the speed of expansion of the five leading foreign grocery retailers across 287 cities, and the fact that only retail goods should be affected by hypermarkets. We pay particular attention to potential confounding factors, such as the effect of differential demand growth. As Chinese cities develop at different rates, their income and preferences evolve in such a way that there is different demand growth for the type of goods multinational retailers provide. Those cities with higher demand growth for retail goods are likely to have higher imports of retail goods and also host more retail stores. Our baseline specification includes city-product-country fixed effects, product-country-year fixed effects and city-country-year fixed effects to account for bilateral-trade shocks between a city and its international partner. We also add separate city-specific time trends in retail and non-retail goods to capture the heterogeneous shift in demand towards imported retail goods across cities as they develop.

Our main finding is a relative rise in imports of retail goods following greater top five multinational retailer activity in China. Exploiting information on the country of origin of imports, we find that only retail-good imports from retailers' country of origin are affected by the presence of the multinational chains. This is in line with the results in Cheptea et al. (2015a), and suggests that retail expansion triggers various falls in transaction costs that specifically benefit home-country producers. Our results are robust to a variety of checks, including an instrumental-variable strategy, a number of placebo tests with the random assignment of products across retail and non-retail categories, as well as the false assignment of the retailers' countries of origin.

We identify two main mechanisms through which the expansion of multinational retailer activities in China may have reduced the trade costs foreign producers face in exporting to China, and so boost their exports to China. First, we find evidence of higher sales of imported groceries by the Western retailers themselves. A major difference between foreign and domestic supermarkets in the sourcing of products concerns food: in domestic supermarkets, imported food products are very rare while they are much more common in foreign stores. We split the relative rise in retailer-good imports into food and non-food products, and find that the observed effect

[3] As their import data is only at the product level, they need to make a number of challenging assumptions to map imports to retail sub-sectors.