INDONESIA RETAIL MARKET:

IT'S POTENTIALS AND CHALLENGES

FOR FOREIGN RETAIL COMPANIES

BY

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THESIS ADVISER RECOMMENDATION LETTER

This thesis entitled **"(Indonesia Retail Market: It's Potentials and Challenges for Foreign Retail Companies)"**prepared and submitted by **(MengXiaolei)** in partial fulfillment of the requirements for the degree of Bachelor of Business Administration in the faculty of Business and International Relations, has been reviewed and found to have satisfied the requirements for a thesis fit to be examined. I therefore recommend this thesis for Oral Defense.

Cikarang, Indonesia, ______________________________

Head of Business Administration Study Program	**Adviser**
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DECLARATION OF ORIGINALITY

I declare that this thesis, entitled **"Indonesia Retail Market: It's Potentials and Challenges for Foreign Retail Companies"** is, to be the best of my knowledge and belief, an original piece of work that has not been submitted, either in whole or in part, to another university to obtain a degree.

Cikarang, Indonesia, ____________________________

MengXiaolei

PANELOF EXAMINERS APPROVAL SHEET

The Panel of Examiners declare that the thesis entitled **"(Indonesia Retail Market: It's Potentials and Challenges for Foreign Retail Companies)"** that was submitted by Meng Xiaolei majoring in Business Administration from the Faculty of Business Administration and International Relations was assessed and approved to have passed the Oral Examinations on ______________________________

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ABSTRACT

In the past five years, the economy of Indonesia has been growing so fast, meanwhile, the income of residents are also increasing, and people have more money to afford what they want. In addition, some good policies have been issued by Indonesia government, so more and more international retailers come to Indonesia those looking for commercial opportunities. But not every company can run their business very well in here, because lack of knowledge of Indonesia, so here the researcher analyzes the retail market from several aspects to demonstrate the current situation of Indonesia.

This thesis is intended to describe the potentials and challenges for foreign retail companies, so that they could operate their business in Indonesia smoothly.

In this thesis, the researcher used qualitative method to analyze the potentials and challenges based on the available secondary data.

This research can provide preliminary guidance for foreign retail companies which intend to do business in Indonesia. From this research, they can evaluate the investment climate and balance the benefits and risks they have to take.

The findings of this study show that there are seven positive factors that influencing foreign retail companies which intend to do business in Indonesia, they are: annual GDP, GDP-real growth rate, Human Capital, Average Hourly Wage, Low Inflation, Rich Labor Force, and GDP-per capita. However, there are also three negative factors, they are: Inefficient Government Bureaucracy, Poor Infrastructure Condition, and Corruption.

Key words: Retail business, Potentials, Challenges, Indonesia

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INTRODUCTION

1.1 Background of the Study

Retailing is the set of business activities that adds value to the products and services sold to consumers for their personal or family use. A retailer is a business that sells products and/or services to consumers for their personal or family use. Retailers are a key component in a supply chain that links manufacturers to consumers. A supply chain is a set of firms that make and deliver goods and services to consumers. Manufacturers typically design and make products and sell them to retailers or wholesalers. When manufacturers like Nike and Apple sell directly to consumers, they are performing both production and retail business activities. Wholesalers engage in buying, taking title to, often storing, and physically handling goods in large quantities and then reselling the goods to retailers or other businesses. Wholesalers and retailers may perform many of the same functions described in the next section, but wholesalers focus on satisfying retailers' needs, while retailers direct their efforts to satisfying the need s of consumers. [1]

U.S. retail sales in 2007 were $4.5 trillion, but this sales level underestimates the impact of retailing on the U.S. economy because it does not include the sales of many consumer services such as entertainment, home repairs, and health care. Approximately 8.1 percent of the total gross domestic product comes from retailing. Although large retail chains account for the majority of retail sales, most retailers are small businesses. Of the 1.9 million retail firms in the United States, 95 percent of them operate only one store; less than 1 percent of U.S. retailers have sales greater than $2.5 million. [2]

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[1]Michael Levy, Ph.D, and Barton A. Weitz, Ph.D. (2012) Retailing Management, 8th edition, p 6, published by McGraw-Hill/Irwin.
[2] Retail Industry Indicators (Washington, DC: National Retail Foundation, August 2008)

Retailing is one of the nation's largest industries in terms of employment. More than 29 million people were employed in retailing in 2007—approximately 21 percent of the nonagricultural U.S. workforce. From 1997 to 2007, retailing added over 1.1 million jobs to the U.S. economy, significantly contributing to U.S. job growth. Even though the period included a recession, retailing still accounted for 6 percent of all new jobs created from 1997 to 2007. Finally, retailing is expected to add another 687,000 jobs by 2016, making it an important source of future job growth. [3]

In today's society the importance of seeking new markets opportunities and extending the business geographically has increased significantly due to intensify competition and globalization. It is more evident than ever before that if companies want to grow they need to think outside the current borders.

As the globalization continues to intensify, more and more retail companies around the world are increasingly looking for business opportunities outside the borders of their home country. In order to be successful and take advantage of low cost opportunities offered in other countries, such as WALMART, CARREFOUR, LOTTE, and also the Brilliance Group CO.LTD.

As we know, Indonesia is the biggest country with a high speed at its economy development among the Southeast Asia countries. More and more foreign businesspersons have joined in the promising and attractive Indonesian market in order to catch some profitable opportunities to do business. Over the last decade a great changes have taken place in Indonesia. Its economy has been growing rapidly with 6.5%[4] speed per year which would make it on track to be the Southeast's largest economy in the near future.

With a population of 231.37 million (2009), Indonesia is the world's fourth most populated country. Indonesia is also the world's largest Muslim country, and it is a very young democracy. Indonesia is the world's largest archipelago. It consists of around 17,500 islands, of which 6,000 are inhabited. The country stretches

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[3] Retail Industry Indicators (Washington, DC: National Retail Foundation, August 2008)
[4]http://www.tradingeconomics.com/indonesia/gdp-growth-annual

5,120 km along the Equator. Indonesia is located in an area which is called the Pacific Ring of Fire. This is an area on the edge of several tectonic plates, and it is known for frequent volcanic and seismic activity. Indonesia has a tropical climate, with average annual rainfall of between 1,780-3,175 mm. There are two seasons; the wet season lasts from October to April, and the dry season from May to September. [5]

However, a lot of issues need to be paid attention to in the business operation. Thus, there are some issues to be presented in this thesis regarding what are the potentials and challenges to do retail business in Indonesia?

1.2 Problems Identified

It is essential for both domestic and foreign retail investors to be familiar with Indonesia unique market and different business vehicles which are competitive and with great challenges. Although in Indonesia there are a great number of opportunities waiting for its investors to explore, we should never ignore the facts that “there are two sides in a coin”, which means some businesses traps are existing.

Therefore, it would be important to do some deep investigations throughout understanding all the different aspects of market and business operation which could be some help for doing businesses in Indonesia effectively in order to gain profits. A research question will be investigated in this thesis, although more aspects are needed to do research in the future study.

1.3 Statement of Problems

It is important for companies to engage in business abroad in order to stay competitive. Even though the decision to start doing business in foreign countries may rational and unavoidable for many companies there are potentials and challenges that could and will affect the business outcome. Based on the problem identified previously I would like to state the problem below.

[5]Doing Business In Indonesia, A Norwegian Perspective Update as of February 2011

What are the main potentials for foreign retail companies to do business in Indonesia and what are the main challenges for foreign retail companies to develop in Indonesia?

1.4 Research Objective

The aim of the thesis is to identify and describe the potentials and challenges for foreign retail companies who are willing to operate in Indonesia, which is in order to achieve benefits for retailers and also contributed to the Indonesia economy.

1.5 Significance of the Study

This research can be a contribution for the foreign retailers who are considering investing in Indonesia.

This research is also expected to give readers additional information that might be useful to handle the similar problems that the readers might face in terms of international business, especially in international retail business study areas.

1.6 Theoretical Framework

Theory that used in this theoretical framework is some previous studies that show the factors influencing foreign direct investment.

In this research, researcher tried to describe the Indonesian retail market: it's potentials and challenges for foreign retail companies. Based on the Dunning's eclectic paradigm theory, there are some factors that make foreign retail companies decide whether operate business in Indonesia or not.

The first four factors are annual GDP, GDP-real growth rate, GDP-per capita, inflation; they will be determinants of economic stability. In general, annual GDP will affect the economic stability; GDP-per capita means people have more income at hand, so it's a potential market for retail companies; inflation can lead to economic health or not, if the inflation is too high, that will affect the price of products, for the retailers, less people will visit the store; GDP-real growth rate measures how fast the economic is growing.

The second three factors are human capital, average hourly wage, and labour force, in general, there are more population that means more potential consumers for the retailers; low wage in terms of low money that retail companies pay to the workers, so it will reduce the cost of doing business; labour force means there are rich skilled workers, so it will increase the job performance of retail companies.

The last three factors that I analyze in this research are infrastructure condition, government bureaucracy, and corruption. In general, good quality of infrastructure can be more attractive by affecting foreign retail's decision; government bureaucracy that will decide if the work is simple or complicated; and doing business in a corrupt country will increase the cost of retailer's.

Based on the theory above, the researcher concludes the theoretical framework of this research will be as follow:

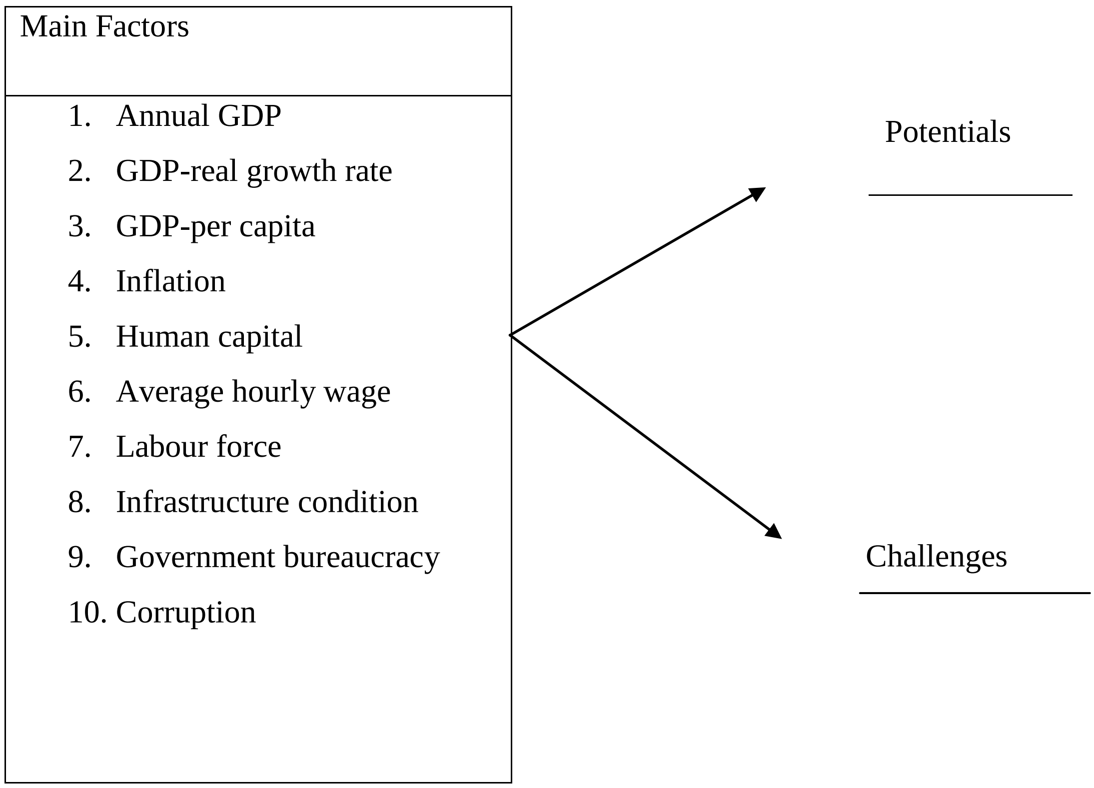

Figure1-1TheoreticalFramework

CHAPTER Ⅱ

LITERATURE REVIEW

Indonesia is a potential market with a population of 231 million, the fourth largest in the world, is a potential market for retail business. A presidential decree No. 118/2000 allowed foreign retailers to operate in the country. Since then a number of foreign retailer companies entered the country operating large outlets such as Hypermarket. Actually, the expansion of supermarkets is just the consequences of foreign direct investment (FDI). FDI has great influence on economic growth of Indonesia. Foreign direct investment in Indonesia rose 30% in the second quarter from a year (2011)earlier to a record 56.1 trillion rupiah ($5.9 billion), suggesting some investors are shrugging off concerns about tough new regulations affecting miners, banks and other companies in Southeast Asia's biggest economy. The inflow of capital for investments in mining, pharmaceuticals and other industries, reported Wednesday by the Investment Coordinating Board, will help ensure that Indonesia remains among the few countries posting relatively strong growth this year despite the euro-zone debt crisis and slowdowns in other major economies.[6]

2.1 The Retail Business

In here, the researcher will just focus on the basic definition of retailing, different types of general merchandise retailers, and also the world top 10 largest retailers.

2.1.1 Definition of Retailing

Levy and Weitz (2012) defined the definition of Retiling as follows, "Retailing is the set of business activities that adds value to the products and services sold to consumers for their personal or family use." (p.6)

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[6]http://online.wsj.com

A retailer purchases goods or products in large quantities from manufactures directly or through a wholesaler, and then sells smaller quantities to the consumer for a profit. Retailing can be done in either fixed locations like stores or markets, door-to-door or by delivery. Retailing includes subordinated services such as delivery. The term “retailer” is also applied where a service provider services the needs of a large number of individuals, such as a public utility, like electric power.

2.1.2 General Merchandise Retailers

The major types of general merchandise retailers are department stores, full-line discount stores, specialty stores, category specialists, home improvement centers, off-price retailers, and extreme-value stores. Table below summarizes the characteristics of general merchandise retailers that sell through stores.

Table 2-1 Characteristics of General Merchandise Retailers

Type	Variety	Assortment	Service	Prices	Size(000 sq.ft.)	SKUs(000)	Location
Department stores	Broad	Deep to average	Average to high	Average to high	100-200	100	Regional malls
Discount stores	Broad	Average to shallow	Low	Low	60-80	30	Stand alone, power strip centers
Specialty stores	Narrow	Deep	High	High	4-12	5	Regional malls
Category specialists	Narrow	Very deep	Low to high	Low	50-100	20-40	Stand alone, power strip centers

Home improvement centers	Narrow	Very deep	Low to high	Low	80-120	20-40	Stand alone, power strip centers
Drugstores	Narrow	Very deep	Average	Average to high	3-15	10-20	Stand alone, power strip centers
Off-price stores	Average	Deep but varying	Low	Low	20-30	50	Outlet malls
Extreme-value retailers	Average	Average and varying	Low	Low	7-15	3-4	Urban, strip

2.1.3 World's Largest Retailers

Table 2-2World's Largest Retailers

Rank	Name of company	Country of origin	2007 Retail sales ($billions)	Countries of operation	2002-2007 Retail sales CAGR(%)
1	WalmartStores,Inc.	U.S.	374,526	15	10.3
2	Carrefour S.A	France	112,604	34	3.6
3	Tesco plc	UK	94,740	13	12.4
4	Metro AG	Germany	87,586	32	4.6
5	The Home Depot, Inc	U.S.	77,349	6	5.8
6	The Kroger Co.	U.S.	70,235	1	6.3
7	Schwarz UnternehmensTreuhand KG	Germany	69,346	24	12.6
8	Target Corp	U.S.	63,367	1	7.6
9	Costco Wholesale Corp	U.S.	63,088	8	10.7
10	AldiGmbH&Co.oHG	Germany	58,487	15	4.3

2.2 FDI Influence Retail in Indonesia

With the speeding up of economy globalization since 1970s, international funds flow more frequently than before. Foreign direct investment (FDI) becomes the main form of fund flow and the main methods of developing countries gaining foreign funds. FDI is acting a more and more important role in global economy. And it will obviously have effects on the developing of host country's economy, especially to developing host country. FDI has been acting a more and more important role in Indonesia's economy development and international trade since 1990s.

While FDI in the wholesale (cash carry) segment and single-brand is allowed, it was only in September 2012, that 51 percent FDI in multi-brand retailing was allowed. Since then a number of foreign retailer companies entered the country operating large outlets such as Hypermarket. The expansion of foreign hypermarket has prompted local retailers to follow their steps. The Matahari Group, which was previously the largest operator of department stores, has opened its own hypermarket outlet. Hero, which has the largest number of supermarket outlets, has also joined in the hypermarket competition. It even plans to expand some of its supermarket outlets to become Hypermarkets. The high increase in the number of modern retail outlets in the country has been attributable mainly to minimarkets, which have recorded a sharp increase in the number of outlets.[7]

Significance of foreign direct investment

The increasing close exchanges in today's world of international technical and financial intermediation growing, how to make good use of foreign investment is an important issue for countries. Rational use of foreign direct investment, to promote national and regional economic development and use of the advantage of foreign capital, technology, management model, some measures for the improvement of economic management and comments are very good. Therefore, to enhance investment to improve the soft environment of national policy is very important.

[7]http://www.marketresearch.com

2.3 Definition of FDI

Foreign Direct Investment can be explained as "incorporated wholly-owned foreign investment, which is the creation of a wholly-owned subsidiary through either acquisition or setting up a new operation on a "Greenfield" site. FDI can also be taken to include wholly-owned concerns plus joint ventures, where a joint venture involves two or more separate bodies forming a jointly-owned entity in which they invest and engage in various decision making activities."

By conducting a foreign direct investment, the corporation does not only penetrate the host country market, but does also gain access to raw materials, labour and other resources. Furthermore, the company rationalizes the production processes as well as diversifies its business. In addition to these advantages, corporations conducting FDI instead of for example exporting, also benefits from reduced trade barriers and lowered transportation costs. The use of a FDI as a tool for entering a market is often also considered being the fastest one. An intensive growth of the technology in the specific industry also motivates FDI. In addition, Watters stated in 1995, that many FDIs are motivated by defensive tactics such as responding to a saturated home market or reacting to problems in the home market.

2.4 The Reasons for FDI occurring

Based on the John H. Dunning's eclectic theory, there are three motivations why FDI occurring

1. Ownership advantage: is a key to explain the existence of MNCS. A key idea is that firms are collections of assets, and that candidate MNCs possesses higher-than-average levels of assets having the character of internal public goods. In other words, the firm must own some unique competitive advantages that overcome the disadvantage of competing with firms on their home market.
2. Location advantage: while international trade theory has tended to take ownership advantage for granted or else to model them in fairly obvious ways, rather more attention has been devoted to exploring alternative

motives for MNCs to locate abroad. Undertaking the business activity must more profitable in a foreign location than its domestic location. For example, the firms can enjoy the lower labour cost and good tax policy by doing business in China.

3. Internalization advantage: the third strand of Dunning's taxonomy is often seen as the most important; in the words of Ethier, "Internalization appears to be emerging as the Caesar of the OLI triumvirate." A pioneering 1937 paper by Ronald Coase argued that the optimal scale of the firm, or the optimal degree of internalization, reflects a balance the transactions costs of using the market and the organizational costs of running a firm.

2.5 Types of FDI

FDI can be broadly classified into two types: outward FDIs and inward FDIs. This classification is based on the types of restrictions imposed, and the various prerequisites required for these investments. An outward-bound FDI is backed by the government against all types of associated risks. This form of FDI is subject to tax incentives as well as disincentives of various forms. Risk coverage provided to the domestic industries and subsidies granted to the local firms stand in the way of outward FDIs, which are also known as "direct investments abroad." Different economic factors encourage inward FDIs. These include interest loans, tax breaks, grants, subsidies, and the removal of restrictions and limitations. Factors detrimental to the growth of FDIs include necessities of differential performance and limitations related with ownership patterns. Other categorizations of FDI exist as well.[8]

2.5.1 Vertical Foreign Direct Investment

Vertical Foreign Direct Investment takes place when a multinational corporation owns some shares of a foreign enterprise, which supplies input for it or uses the output produced by the MNC.

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[8]http://www.studymode.com/essays/Foreign-Direct-Investment-162071.html

2.5.2 Horizontal foreign direct investments

Horizontal foreign direct investments happen when a multinational company carries out a similar business operation in different nations. Foreign Direct Investment is guided by different motives. FDIs that are undertaken to strengthen the existing market structure or explore the opportunities of new markets can be called "market-seeking FDIs." "Resource-seeking FDIs" are aimed at factors of production which have more operational efficiency than those available in the home country of the investor. Some foreign direct investments involve the transfer of strategic assets. FDI activities may also be carried out to ensure optimization of available opportunities and economies of scale. In this case, the foreign direct investment is termed as "efficiency-seeking." [9]

2.6 Advantages of FDI

2.6.1 Economic Development

Recent studies show that foreign direct investment is one of the main driving forces for promoting economic growth. Especially in some developing countries, foreign direct investment has a very important impact on economic growth.

For example, one of the analysts compared the economic effects of domestic and foreign direct investment. He found that the domestic capital contribution to economic growth than foreign capital, but they all contribute to the economic development of the country. Foreign direct investment is an important channel for the introduction of new technology, its contribution to the national economic than domestic investment. Someone even say lack of foreign investment is the main reason of recession.

As a capital stock, the inflow of foreign capital can increase the overall financial resources for investment to ease the potential bottleneck in the development, such as savings and foreign exchange shortages.

[9]http://www.indianmba.com/Occasional_Papers/OP203/op203.html

2.6.2 Transfer of Technologies

Foreign direct investment can bring the advanced technology equipment and scientific management experience and management mode to the country, it will help the local company to learn the new technology, improve the weakness, and increase the competitive of Indonesia enterprises.

2.6.3 Human Capital Resources

Foreign direct investment is an important source of human capital agglomeration and technological change in the developing countries. In developing countries, the general production technology is relatively backward, poor quality of the staff, the lack of experience in modern management and marketing skills. Therefore, foreign direct investment, especially the entry to large multinational companies, the transfer of state-of-the-art technology, management and marketing experience to the host country, so as to improve production efficiency and factor productivity of the host country. Foreign direct investment to enhance the technical performance of this role in the domestic sector of the host country can be enormous, although this role is sometimes difficult to measure.

2.6.4 Job Opportunity

Foreign direct investment (FDI) helps in the creation of new jobs in a particular country. It also helps in increasing the salaries of the workers. This enables them to get access to a better lifestyle and more facilities in life. It has normally been observed that foreign direct investment allows for the development of the manufacturing sector of the recipient country. Foreign direct investment can also bring in advanced technology and skill set in a country. There is also some scope for new research activities being undertaken.

2.6.5 Income Generation

Foreign direct investment (FDI) assists in increasing the income that is generated through revenues realized through taxation. It also plays a crucial role in the context of rise in the productivity of the host countries. In case of countries that make foreign direct investment in other countries this process has positive impact as well. In case of these countries, their companies get an opportunity to explore newer markets and thereby generate more income and profits. [10]

2.6.6 Export/Import

It also opens up the export window that allows these countries the opportunity to cash in on their superior technological resources. It has also been observed that as a result of receiving foreign direct investment from other countries, it has been possible for the recipient countries to keep their rates of interest at a lower level. It becomes easier for the business entities to borrow finance at lesser rates of interest. The biggest beneficiaries of these facilities are the small and medium-sized business enterprises.

Foreign direct investment (FDI) leads to increase in profits within different industries as well as tax cuts and expanded marketability for singularly differing industries. Often times procurement of properties, buildings, and labor can be obtained at a fraction of the cost in host countries than would be the case within the company's home country. While this may seem unfair, it is a good idea to keep in mind the host countries economy and market. Companies are often forced to abide by local regulations rather than the regulations of their home country. On the other side of the coin, the host country benefits due to the increase in jobs it produces in the regional labor market to which the investment companies reach out to. Often times dying economies can be revived in the process of becoming a host for certain industries or markets in which that industry or market had not previously been. This is especially the case with third world countries that are trying to catch up to industrial nations or who need a boost due to changes in regional climates or in the advent of recovery from the aftermath of civil or world war.[11]

2.6.7 The promotion of trade structure optimization

Foreign direct investment has had a positive impact on the optimal adjustment of Indonesia’s trade structure, on one hand, foreign direct investment has a direct effect on the changes in the structure of trade, foreign-invested enterprises export

[10]http://www.indianmba.com/Occasional_Papers/OP203/op203.html
[11]http://www.indianmba.com/Occasional_Papers/OP203/op203.html

commodity structure to further optimize the structure of Indonesia’s export basic realization of fundamental shift from primary products to manufactured goods.

On the other hand, foreign direct investment has indirect trade effects, which are through the production technology and marketing knowledge spillover, the transfer of the marketing network and demonstration effect, bringing the improvement of the domestic enterprises to export of finished goods, which led to the development of Indonesian enterprise export.

2.7 FDI in Indonesia

During the 1960s and 1970s, inward foreign direct investment mainly likes to invest in the oil and natural gas sector. In the 1980s and 1990s, the Indonesian government introduced a lot of new regulation that attract foreign direct investment invest its domestic market, especially the manufacturing and services sectors. Since then, a lot of foreign companies came to invest in Indonesia.

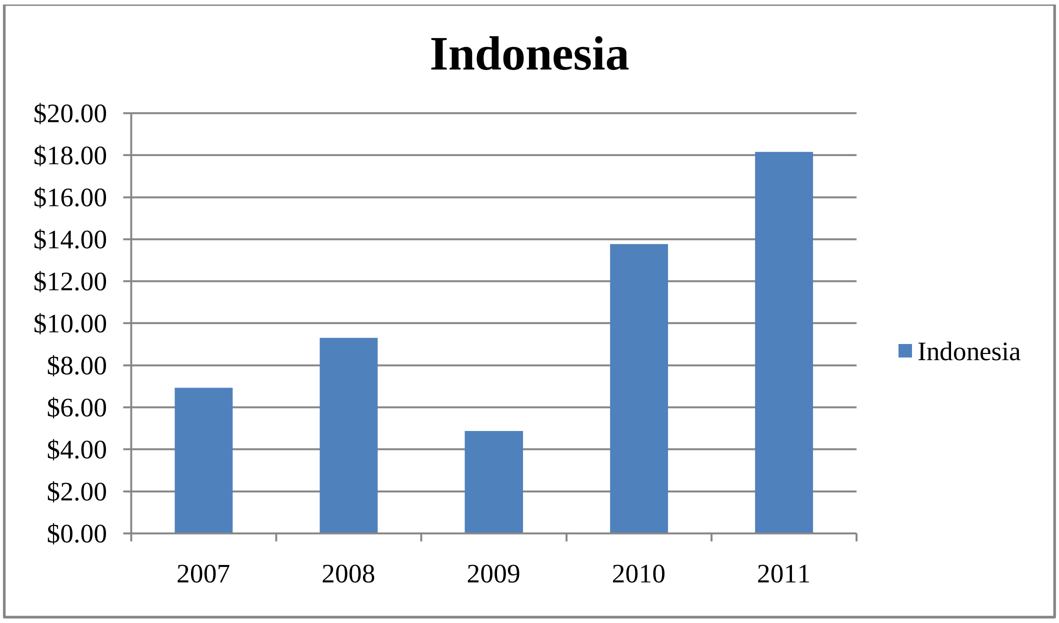

Figure 2-1 FDI in Indonesia (current US$ in billions)

Source: World Bank

Table 2-3Sectoraldistribution of inward FDI in Indonesia, 2006-2009 (US$ million)

Sector/industries	2006	2007	2008	2009

All sectors	5,991.7	10,341.4	14,871.4	10,815.2
Primary	532.4	599.3	335.6	462.6
Agriculture, forestry, and fishing				
Food crops and plantations	351.9	219.1	147.4	122.3
Mining, quarrying and petroleum				
Mining	98.0	309.8	181.4	332.7
Secondary	3,619.7	4,697.0	4,515.2	3,831.1
Manufacturing				
Food industry	354.4	704.1	491.4	552.1
Textile industry	424.0	131.7	210.2	251.4
Leather industry	51.8	95.9	145.8	122.6
Wood industry	58.9	127.9	119.5	62.1
Rubber and plastic industry	112.7	157.9	271.6	208.1
Metal, machinery electronic industry	955.7	714.1	1,281.4	654.9
Motor vehicle and other transportation equipment industry	438.5	412.3	756.2	583.4
Construction	144.2	448.2	426.7	512.7
Services	1,839.5	5,045.1	10,010.5	6,521.2
Transport, storage and	646.0	3,305.2	8,529.9	4,170.3

communication				
Trade and repair	434.2	482.9	582.2	706.1
Electricity, gas and water supply	105.3	119.3	26.9	349.2
Real estate and business activities	254.0	64.5	174.9	315.1

Source: National Coordinating Agency for Investment (BKPM)

2.8 Factors influencing FDI

Foreign Direct Investment plays a very important role in the development of any nation. It must be understood that foreign direct investment is vital especially in the case of underdeveloped and developing countries.

In such cases, foreign direct investment plays an important role of bridging the gap between the available resources or funds and the required resources or funds. However, in order to attract such investment the governments of such economies must make their policies more investor friendly, in addition to these policies, highlighted below are some of factors which affect foreign direct investment to a large extent.

Size of the Market

This is true as studies conducted over time show that there is a strong correlation between the size of the domestic markets and the FDI that these countries attract. This is due to the fact that the investment must justify the returns which are to be derived through sales made with in the country. This is the reason why that even though some third world African countries although blessed with abundant natural resource still lack the needed FDI investment on account of small and fragmented markets.

In this sector, the research would like to take GDP growth of Indonesia, GDP growth rate, and GDP growth per capital as indicators to measure Indonesia market, to find out the challenges and opportunities.

2.8.1 GDP growth

The Gross Domestic Product or GDP is a measure of all of the services and goods produced in a country over a specific period, classically a year. This measure considers the market value of goods and services to arrive at a number which is used to judge the growth rate of the economy and the overall economic health of the nation concerned.

As an economic measure, the GDP can be a very useful yardstick, but it has some serious flaws which have led some people to propose the use of alternate measures of economic and social well being.

When a GDP is calculated, it includes all private and government spending, goods and services produced, and exports. It is adjusted for imports and inflation to arrive at a number which is believed to accurately reflect the sum total of the nation's goods and services. The GDP can be expressed as a bulk number, but it is more commonly converted into a per capita figure, creating a number which reflects the average per citizen. High per capita GDPs are associated with overall improvements in standards of living.[12]

2.8.2 GDP Growth Rate

The GDP growth rate measures how fast the economy is growing. The GDP growth rate is driven by the four components of GDP. By far, the most important driver of GDP growth is personal consumption, which is 70% of the total economic output. This includes retail sales. GDP growth is also driven by business investment, which includes construction and inventory levels. Government is another driver of growth, and is sometimes necessary to jumpstart the economy after a recession. Last, but not least, are exports and imports. Exports drive growth, but increases in imports have a negative impact.

The GDP growth rate is the most important indicator of economic health. If it's growing, so will business, jobs and personal income. If it's slowing down, then businesses will hold off investing in new purchases and hiring new employees, waiting to see if the economy will improve. This, in turn, can easily further depress the economy and consumers have less money to spend on purchases. If the GDP growth rate actually turns negative, then the U.S. economy is heading towards or is already in a recession.

When the economy is expanding, the GDP growth rate is positive. However, in a recession, the economy contracts as well. When that happens, the GDP growth rate is negative. This happened most recently in 2008 and 2009, when the GDP growth rate was negative for four quarters in a row. The last time this happened was during the Great Depression. The growth rate turned positive in Q2 2008,

[12] http://www.wisegeek.com/what-is-gdp.htm

and then turned negative again, prompting concerns about a double-dip recession. The growth rate was negative for two quarters during the 2001 recession.[13]

2.8.3 GDP Growth per Capital

GDP per capita is the share of individual members of the population to the annual GDP. Mathematically it is calculated by dividing real or nominal GDP by the number of population per year.

GDP per capita is indicator of the average standard of living of individual members of the population. An increase in GDP per capita signifies national economic growth. As such, economic planners and forecasters used the GDP per capita in monitoring economic growth trend for time series. It aids them in developing economic policies and development plans since the trend in GDP per capita at a specific period would clearly indicates whether the standard of living of the population is improving or not. A declining trend in GDP per capita indicates a sinking economy. Therefore, economic planners must come up with policies and infrastructures to facilitate economic growth. An increasing trend in the GDP per capita on the other hand, would prompt economic planners to implement various structural adjustments to prevent inflation rate from increasing due to increase in the purchasing power of the individual members of the population. Although faced with many issues and questions regarding the use of GDP as an indicator of standard of living, economic critics could not discount the advantages of using GDP to gauge the standard of living. For one, GDP is widely used and accepted in many countries. It is frequently updated and monitored by country specific statistical bodies. This enables country planners and economic think thanks to monitor the economic trend in a country of regular and periodic basis.[14]

2.8.4 Labor Cost

Labor cost forms a major chunk of total product costs of many countries and hence MNCs try to find economies in which there exist cheaper labor costs. This is the reason why many manufacturing and services organizations are investing in countries like Indonesia and China which have plenty of cheap labor.

[13]http://useconomy.about.com
[14]http://www.nationmaster.com

In the sector, the study would like to take education level of labor force as indicators. The indicator is capable to show the current condition of Indonesia labor force, somehow, could show the price of labor force.

2.8.5 Inflation

In economics, inflation is a rise in the general level of prices of goods and services in an economy over a period of time. When the general price level rises, each unit of currency buys fewer goods and services. Consequently, inflation also reflects erosion in the purchasing power of money – a loss of real value in the internal medium of exchange and unit of account within the economy.

Inflation's effects on an economy are various and can be simultaneously positive and negative. Negative effects of inflation include an increase in the opportunity cost of holding money, uncertainty over future inflation which may discourage investment and savings, and if inflation is rapid enough, shortages of goods as consumers begin hoarding out of concern that prices will increase in the future. Positive effects include ensuring that central banks can adjust real interest rates, and encouraging investment in non-monetary capital projects.[15]

2.8.6 Infrastructure

More FDI is likely to occur in countries with good physical infrastructure such as bridges, ports, highways, etc. It also seems like that there are some diminishing returns in infrastructure, at least in infrastructure of a specified type. The first bridge is more important than the second than the third…than the hundredth, and so on. Therefore, especially for countries with poor infrastructure, investing in improvements in infrastructure may be important for attracting FDI. Nonetheless, some countries with poor infrastructure may be unattractive hosts for FDI for a variety of other reasons, and even substantial investments in infrastructure might not bring FDI pouring in. But all else equal, a country with more infrastructures would be expected to attract more FDI (as well as more domestic investment)

The positive effect of infrastructure on FDI has been found to be quite robust to time periods and countries considered, other control variables included, and the like. Examining the determinants of FDI into U.S. states for 1981-1983, Coughlin

[15]https://www.boundless.com/economics/welcome-to-economics/economy-as-whole/inflation/

et al (1991) find that more extensive transportation infrastructures were associated with increased FDI. [16]

Wheeler and Mody (1992) find that infrastructure quality is an important variable for developing countries seeking to attract FDI from the overseas countries, but is less important for developed countries that already have high quality infrastructure.

Using a self-reinforcing model of FDI, Cheng and Kwan (2000) find support for good infrastructure as a determinant of FDI into 29 Chinese regions from 1985 to 1995. The quality of the roads, however, did not seem to matter much: high-grade paved roads did not perform any better than all roads in determining which regions hosted the most FDI. [17]

Infrastructure is basic physical and organizational structures needed for the operation of a society or enterprise, or the services and facilities necessary for an economy to function. It can be generally defined as the set of interconnected structural elements that provide framework supporting an entire structure of development. It is an important term for judging a country or region's development.

The term typically refers to the technical structures that support a society, such as roads, bridges, supply, sewers, electrical grids, telecommunications, and so forth, and can be defined as "the physical components of interrelated systems providing commodities and services essential to enable, sustain, or enhance societal living conditions."

Infrastructure facilitates the production of goods and services, and also the distribution of finished products to markets, as well as basic social services such as schools and hospitals; for example, roads enable the transport of raw materials to a factory. In military parlance, the term refers to the buildings and permanent installations necessary for the support, redeployment, and operation of

[16] Coughlin, Cletus C, Joseph V. Terza, and VachiraArromdee. 1991. “State Characteristics and the Location of Foreign Direct Investment within the United States” Review of Economics and Statistics 73(4):675-83. Finds that more extensive transportation infrastructures were associated with increased FDI into US states.

[17] Cheng, Leonard K., and Yum K. Kwan. 2000. “What are the Determinants of the Location of Foreign Direct Investement? The Chinese Experience.” Journal of International Economics 51(2):379-400. Evidence that good infrastructure, measured as density of all roads, matters for FDI into Chinese regions.

military forces. To make it simple, infrastructure is anything that is needed every day, an everyday item.

Infrastructure of any economy is vital to the development of trade and commerce. Only when the country has an adequate system of transportation like ports, airports, roadways and railways, power, water supply, warehouses and other kinds of infrastructure can the economy attract foreign direct investment. Foreign investors look and see whether such infrastructure exists so that business can carry on smoothly otherwise bad infrastructure may lead to problems related to supply chain and manufacturing which may then ultimately lead to prohibitive cost structures.

In the sector, the study would like to take indicators as the following.

1) Roads and railways 2) Airports, sea-ports, and inland waterways

3) Telecommunications4) Electricity 5) water and sanitation

Openness

The host country must bear in mind that its policies must be open and investor friendly. Foreign investors must be able to freely setup facilities without much governmental hassles. Also, profits, dividends and gains made from operation during a year within the country must be freely.

If countries want to attract FDI, they should prepare themselves, because investors must investigate before they actually do it. As long as investors find out that there are so many barriers that could not see hope, they would take off as soon as possible. During the progress, government has been played a very important role because relevant policies could take investors out of different troubles; even get the understanding of citizens.

In the sector, the study would like take government bureaucracy and corruption as indicators.

2.8.7 Government Bureaucracy

A bureaucracy is a group of non-elected officials within a government or other institution that implements the rules, laws, ideas, and functions of their institution. Contemporary analysis of comparative bureaucratic structures needs to move beyond Weber, but Weber's characterizations do pro-vide a simple, accessible starting point for comparative research. In contrasting bureaucracies with prior organizational forms, We-better stressed a number of points that lend themselves to relatively objective empirical assessment. We emphasize two of these. The first is the importance of meritocratic recruitment, which ideally is based on some combination of education and examination. The second is a predictable career ladder, which provides long-term tangible and intangibles rewards for those recruited into the bureaucracy. [18] We could have selected other Weber an organizational features. One advantage of meritocratic recruitment and rewarding/predictable career ladders is that these features are relatively easy to translate into simple measures that can be evaluated across countries; hence focusing on them facilitates empirical testing. Also, plausible theoretical connections can be constructed between these features and improved organizational ability to deliver the collective goods that constitute the state's potential contribution to economic growth.[19]

Meritocratic recruitment not only increases the likelihood of at least minimal competence but also helps generate corporate coherence and esprit de corps, which in turn can be argued to have substantive effects on the motivation of individual officeholders. Bureaucrats who see themselves as having joined their confreres in office by virtue of sharing similar abilities are more likely to internalize shared norms and goals than are those who know they owe their office to the favor of a particular kinsman or patron. Identification with colleagues and the organization itself should also create internalized in-tangible costs for corrupt activities that subvert organizational goals and increase the effectiveness of monitoring.[20]

Offering rewarding long-term careers might also increase competence in the long run, but, regardless of their effects on competence, such careers will increase corporate coherence. Likewise, the predictable prospect of long-term career rewards reduces the relative attractiveness of the quick returns available from corrupt individual practices. This is obvious insofar as one of the aspects of long-term career rewards is competitive salaries. It is equally clear that careers that provide the expectation of a series of promotions related to performance and conformity to organizational norms create disincentives to corrupt behavior, especially if such behavior undermines organizational goals. The costs of breaking organizational norms are also directly proportional to the expected

[18]Gerth, Hans and C.W. Mills. 1958. From Max Weber: Essays in Sociology. New York: Oxford University Press. (Gerth and Mills 1958:241; Parsons 1964:333, 339)
[19]Peter Evans and James E. Rauch, 1999. American Sociological Review, Vol. 64, No. 5 , p 748-765
[20]http://www.social-sciences-and-humanities.com/PDF/bureaucracy_and_growth.pdf

longevity of membership in the organization and the expected rewards to longevity. [21] Overall, meritocratic recruitment and predictable career ladders should help structure the incentives of individual bureaucrats in a way that enhances the ability of the organizations they manage to effectively pursue long-term goals.

If the argument that these structural features contribute to a more competent, purposive, and cohesive bureaucracy is accepted, myriad specific causal paths leading to higher rates of economic growth are plausible. The longer time horizons associated with predictable, rewarding careers will increase the bureaucracy's propensity to advocate public-sector infrastructure investment rather than consumptive expenditures. Because the returns from public infrastructure investments depend essentially on their "system-nests," the coherence of the bureaucracy should enhance their effectiveness. Likewise, the reduction in individual maximizing (i.e., corrupt) practices should reduce the implicit tax on the private sector that such practices represent.[22]

From all these theories we could know, every company goes to another country to invest that they will consider the infrastructure of quality of the country of destination. A good infrastructure is not only good for domestic citizens, but also can attract more people or more foreign companies to invest in their country. Good quality of infrastructure can be an important element that makes decision.

2.8.8 Corruption

Due to the various forms that corruption can take, including practices such as bribery, extortion, influence, and fraud, and embezzlement, corruption has been defined in different ways. Yet, since we are concerned only with corruption that affects the costs of investment operations, we use Macrae’s (1982: 679) definition. He defines corruption as an “arrangement” that involves “a private exchange between two parties (the ‘demander’ and the ‘supplier’), which (1) has an influence on the allocation of resources either immediately or in the future, and involves the use or abuse of public or collective responsibility for private ends.” The demanders in our case may be the public officials and the suppliers are foreign investors.[23]

The debate on the adverse effects of the level of corruption on FDI inflows has been analyzed in context of the costs of doing business. Since foreign investors have to pay extra costs in the form of bribes in order to get licenses or

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[21]Stinchcombe (1974) focuses on industrial rather than administrative bureaucracies but provides a very relevant analysis of the role of careers in shaping individual motivations (e.g,pp134-5 and 147-8).

[22]http://www.social-sciences-and-humanities.com/PDF/bureaucracy_and_growth.pdf

[23]Macrae, J. (1982) “Underdevelopment and the Economics of Corruption: A Game Theory Approach.” World Development 10(8):677-87

government permits to conduct investment, corruption raises the costs of investment. Such additional costs decrease the expected profitability of investment and so corruption is generally viewed as a tax on profits (Bardhan 1997). Moreover, corruption increases uncertainty because corruption agreements are not enforceable in the courts of law.[24]

It has been shown that corruption has adverse effects on economic performance. Corruption has a negative impact on the level of investment and economic growth,[25] on the quality of infrastructure and on the productivity of public investment,[26] on health care and education services,[27] and on income inequality.[28] All those factors are found to be important determinants of FDI location. Therefore, foreign investors would tend to avoid investing in countries with high levels of corruption.

However, there may exist positive effects of corruption on FDI inflows. In the presence of a rigid regulation and an inefficient bureaucracy, corruption may increase bureaucratic efficiency by speeding up the process of decision-making. However, this view has been rejected empirically. Kaufman and Wei (1999) using firm level data covering more than 2,000 firms find that firms paying more bribes spend more time negotiating with bureaucrats. But two recent studies show that the effects of corruption depend on the country's rule of law and economic freedom.[29] Houston(2007), studying the effects of corruption on a country's economic performance, finds that corruption has positive effects on economic growth in countries with a weak rule of law, while it has negative effects in countries with sound institutions.[30] Also, Swaleheen and Stansel (2007) find that corruption enhances economic growth in countries with high economic freedom, while it hinders economic growth in countries with low economic freedom.[31]

Corruption is the misuse of public power or authority for private gain. Corruption tends to arise when government control access to markets, so naturally corruption can matter for FDI. Wei (2000) established corruption's deterrent effect on FDI. Using data on bilateral investment from twelve source countries to 45 host

[24]Bardhan, P. (1997) "Corruption and Development: A Review of Issues." Journal of Economic Literature 25:1320-46.
[25]Mauro, P. (1995) "Corruption and Growth." Quarterly Journal of Economics 110(3):681-712.
[26]Tanzi, V., and Davoodi, H. (1997) "Corruption, Public Investment and Growth." IMF Woring Paper No. 139. Washington: International Monetary Fund.
[27]Gupta, S.; Davoodi, H.; and Tiongson, E. (2000) "Corruption and the Provision of Health Care and Education Services." IMF Working Paper No. 116. Washington: International Monetary Fund.
[28] Gupta, S.; Davoodi, H.; and Alonso-Terme, R. (1998) "Does Corruption Affect Income Inequality and Proverty?" IMF Working Paper No. 76. Washington: International Monetary Fund.
[29] Kaufman, D., and Wei, S. (1999) "Does Money' Speed Up the Wheels of Commerce?" NBER Working Paper No. 7093.
[30]Houston , D. (2007) "Can Corruption Ever Improve an Economy?" Cato Journal 27(3):325-42.
[31]Swaleheen, M., and Stansel, D. (2007) "Economic Freedom, Corruption, and Economic Growth." Cato Journal 27(3):343-58.

countries, Wei finds that an increase in the corruption level in the host country leads to a reduction in inward FDI. An increase in the corruption level from that of Singapore to that of Mexico is estimated to have the same effect of deterring inward FDI as raising the tax rate by fifty percent. [32]

Not just the level of corruption in a host country, but the degree to which it differs from the level in the source country, may matter for FDI. Habib and Zurawicki (2002) provide support for the negative impact on FDI of both the level of corruption in the host country and the absolute difference in the corruption level between the host and the source country.[33] MNEs from a country with high degrees of corruption may be better able to deal with high levels of corruption in a host country than firms from a country with little corruption. The former firms are experienced in dealing with corruption, whereas the latter are accustomed to transparency. Of course, corruption may take many forms, and thus experience from one country may not fully translate to another. On the other hand, firms accustomed to dealing with bribery might be able operate well in less corrupt environments, but even they may undergo some adjustment to the different environment. Especially when there is still some corruption, it may be hard for foreign firms to learn just where bribes are needed and where rules must be followed.

While many papers operate on the notion that corruption deters FDI, the opposite can be argued as well. In fast-growing countries with substantial bureaucracies, the ability of corruption to "grease the wheel" may be more important than the amount of the bribe required. In such situation, the bribe may be considered a small price to pay for cutting through many layers of red tape and speeding up approval. When weighing costs versus benefits, how big of a bribe is required must be compared to how much of an improvement in speed or likelihood of approval is gained. The terms "helping hand" versus "grabbing hand" corruption has been used to distinguish corruption that positively affects FDI from that which negatively affects FDI.

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[32] Wei, S. (2000a) "How Taxing Is Corruption on International Investors." Review of Economics and Statistics 82:1-11.

[33] Habib, M., and Zurawicki, L. (2002) "Corruption and Foreign Direct Investment." Journal of International Business Studies 33(2):291-307.

Corruption is a big problem for every country all over the world, all the analysis that we have seen that says corruption is a big obstacle for the country which attract foreign direct investment, it shows us that less corrupt can attract more foreign direct investment, so every nation must work harder on stop fighting with corruption. But on the other hand, some people also like to do business in a corrupt country, for example, the dirty business, selling drugs, smuggle, etc so just in case they are caught by the police or custom, they still can walk out from the prison, of course, this is a bad example.

CHAPTER III

METHODOLOGY

3.1 Research Method

Yin (1989) states that if the research should take a qualitative or quantitative approach, depends on the nature of the research questions and the information you as a researcher aim at gaining.

Quantitative analysis is the scientific approach to managerial decision making. Whim, emotions, and guesswork are not part of the quantitative analysis approach. The approach starts with data. Like raw material for a factory, these data are manipulated or processed into information that is valuable to people making decisions. This processing and manipulating of raw data into meaningful information is the heart of quantitative analysis. Computers have been instrumental in the increasing use of quantitative analysis.

Qualitative research is a method of inquiry employed in many different academic disciplines, traditionally in the social sciences, but also in market research and further contexts. Qualitative researchers aim to gather an in-depth understanding of human behavior and the reasons that govern such behavior. The qualitative method investigates the why and how of decision making, not just what, where, when. Hence, smaller but focused samples are more often needed than large samples. In the conventional view, qualitative methods produce information only on the particular cases studied, and any more general conclusions are only propositions. Quantitative methods can then be used to seek empirical support for such research hypotheses.

Qualitative researchers study things in their natural settings, attempting to make sense of, or to interpret, phenomena in terms of the meanings people bring to them (Denzin 1994). Qualitative research is intended to penetrate to the deeper significance that the subject of the research ascribes to the topic being researched. It involves an interpretive, naturalistic approach to its subject matter and gives priority to what the data contribute to important research questions or existing information. Within health care an understanding of the value of evidence from qualitative research to systematic reviews must consider the varied and diffuse nature of evidence (POPAY 1998b, Pearson 2005). Qualitative research encompasses a range of philosophies, research designs and specific techniques including in-depth qualitative interviews; participant and non-participant observation; focus groups; document analyses; and a number of other methods of data collection (Pope 2006). Given this range of data types, there are also diverse methodological and theoretical approaches to study design and data analysis such as phenomenology; ethnography; grounded theory; action research; case studies; and a number of others. Theory and the researchers' perspective also play a key role in qualitative data analysis and in the bases on which generalizations to other contexts may be made. Within the empirical sciences, the standing of a given theory or hypothesis is entirely dependent upon the quantity and character of the evidence in its favor. It is the relative weight of supporting evidence that allows us to choose between competing theories. Within the natural sciences, knowledge generation involves testing a hypothesis or a set of hypotheses by deriving consequences from it and then testing whether those consequences hold true by experiment and observation. [34]

Qualitative methods are often related to case studies, where the aim is to receive thorough information and thereby obtain a deeper understanding of the research problem. The research can be described as qualitative when the researcher collects, analyzes and interpret detailed data concerning ideas, feelings and attitudes. A qualitative research is characterized by a great closeness to the respondent, or any other source that the data is collected from. The data should be collected in situations or circumstances that are similar to ordinary and everyday conversation. Qualitative research means gathering, analyzing and interpreting data that no quantifiable.

If the researcher is looking for formalized and well-structured information, the quantitative approach is most suitable. Distance to the source also characterized this method. The researcher has beforehand decided what questions to be asked without considering whether the respondent finds them important or not. This gives the researcher a high degree of control. Researcher using the quantitative approach often seeks patterns and relationships that can be expressed in numbers rather than words.

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[34] http://www.mrc-bsu.cam.ac.uk/cochrane/handbook500/chapter_20/20_2_1_definition_of_qualitative_research.htm

Based on my topic “Indonesia Retail Market: it is potentials and challenges for foreign retail companies”. So in this research I decided to choose qualitative method as my research method. By using this method, it is a very effective way to have deeper understanding of the investigations. The qualitative method uses the collection of data to describe rather than to draw statistical analysis. This approach will yield a more in-depth understanding through the transformation of the information collected into written words.

3.2 Research Instrument

There are many research instruments that could be used to collect data and analyze the data, such as interviews, surveys, literature reviews, participant observations, etc. To describe the potentials and challenges of Indonesia retail market for foreign retail companies, this research uses literature reviews, because literature review ensures the research hasn’t been done before; enable the researcher to learn from previous theory on the subject; shows where the research fits into the existing body of knowledge, etc.

3.3 Nature of Data

Since there are so many constraints, such as limited time and limited resources, it is difficult to collect the primary data for me, this research uses secondary data. Secondary data is the term used for data that has already been collected for a specific purpose and then is used again during other circumstances for other reasons. This type of data is primarily used when the researchers do not have enough time and data is needed quickly. In such a situation the secondary data is seen to be of higher quality than the primary data. A common disadvantage when using secondary data is that the data could be unsuitable for the specific purpose. The choice of approach lies to ground for how the researcher will collect and analyze the data and should be decided dependent on the nature of the research topic (Saunders et al., 2006).

3.4 Source of Data

The study is going to use secondary sources in order to explore the research question. The secondary data will consist of articles, books, thesis, and course literature from libraries. Online resource will be the main material that researcher used.

3.5 Scope and Limitations of the Study

The research will focus on the potentials and challenges for foreign retail companies which will be doing business in Indonesia. Due to the limited time and resources, there are only limited investigations which are to be taken. This research mainly analyzes the potentials and challenges for whom to operate retail business in Indonesia. Since there are a lot of factors that will influence the decision of foreign retail companies, so the research is not easy to be done in all the fields of economic. Therefore this study will limit on the macro performance analysis.

CHAPTER IV

ANALYSIS OF DATA AND INTERPRETATION

OF RESULTS

4.1 Data Analysis

In this chapter, the researcher will provide data analysis and interpretation that include data organization and rank the data into category and basic denomination of description. In addition, there are 10 important factors that the researcher will analyze in detail.

4.2 Main Factors

There are 10 factors that the researcher is going to analyze, they are: annual GDP of Indonesia from 2007-2011; GDP–real growth rate; Human Capital; Average Hourly Wage; Infrastructure Condition; Government Bureaucracy; Inflation; Corruption; Labour Force and GDP-per capita.

4.2.1 Annual GDP (Current US$ Billions)

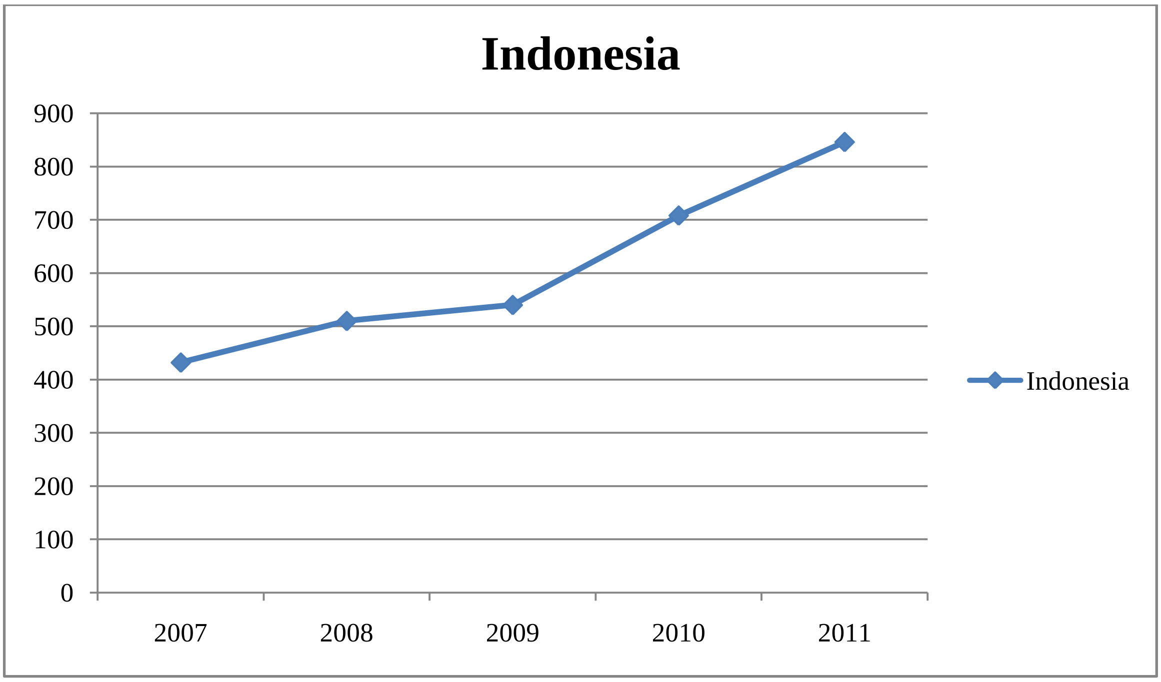

Figure 4-1 GDP of Indonesia from 2007-2011

Source: data World Banksearch

From this figure that we can see, for the last 5 years, the annual GDP of Indonesia is growing, as you know, even though in 2008 there was financial crisis all over the world, but the GDP of Indonesia was still growing, according to this phenomenon that we could predict for the next 5 years the GDP of Indonesia will be still growing, as a brilliant investor, there is no doubt that they do not invest in Indonesia, so the researcher can say this is positive factor for the investor who will be doing business in Indonesia.

4.2.2 GDP –real growth rate (%)

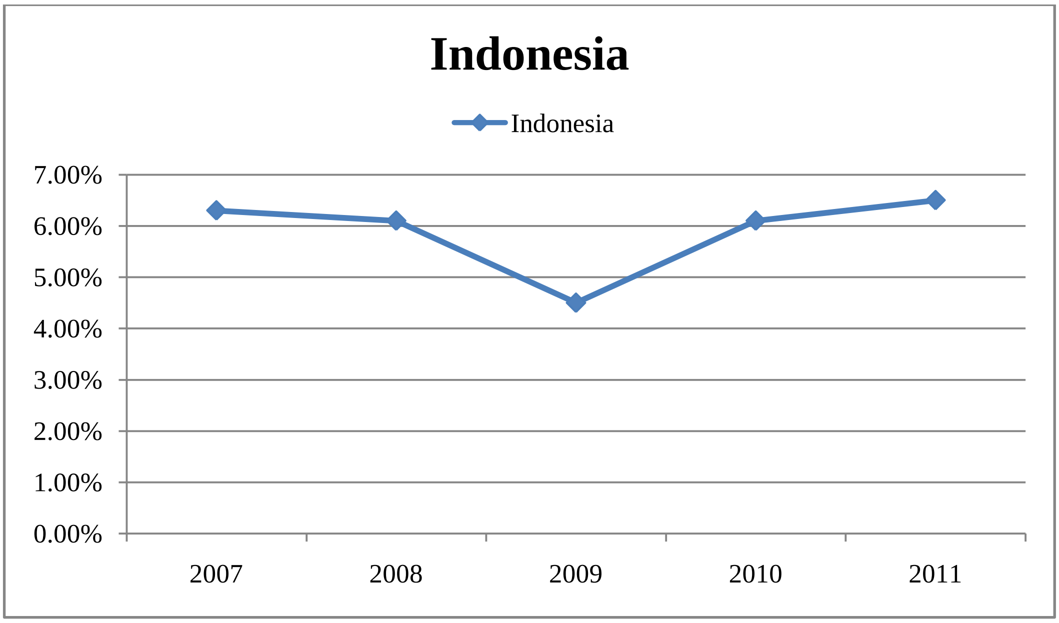

Figure 4-2 GDP annual growth rate

Source: CIA World Factbook

The GDP growth rate measures how fast the economy is growing. It does this by comparing one quarter of the country's economic output to the last. As we know, the GDP growth rate is the most important indicator of economic health. If it's growing, so will business, jobs and personal income. If it's slowing down, then businesses will hold off investing in new purchases and hiring new employees, waiting to see if the economy will improve. This, in turn, can easily further depress the economy and consumers have less money to spend on purchases.

From this figure we can see, from 2007 to 2008 the GDP growth rate is slowing down, in addition, in 2009 the growth rate reached a low level by comparing with before, but after 2009 until 2011, the growth rate is growing.

4.2.3 Human Capital

Population

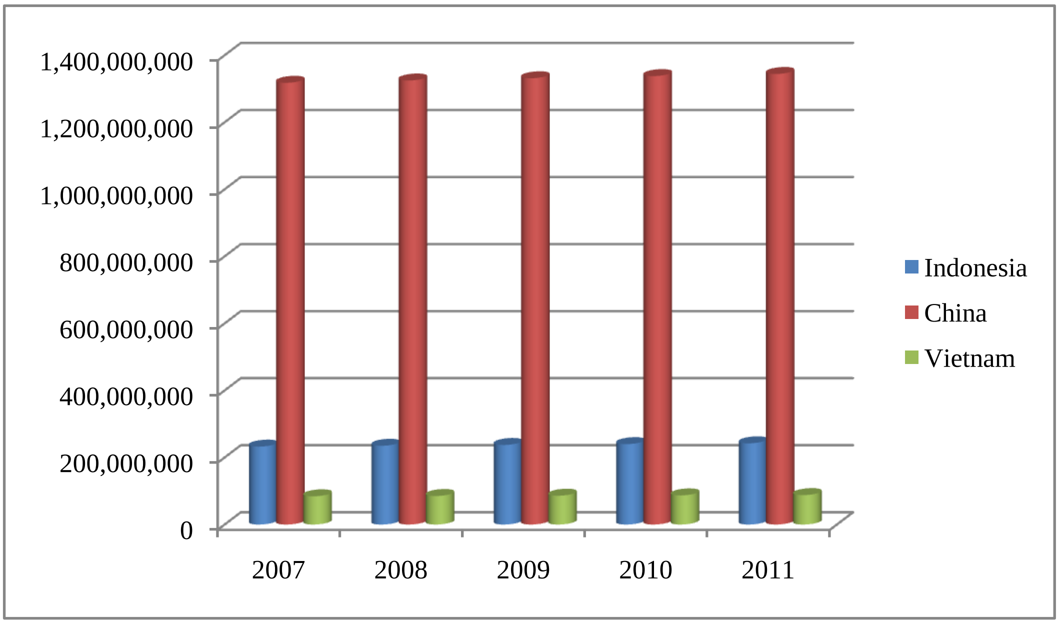

Figure 4-3Population from 2007-2011

Source: World Bank Group, world development indicators

The 2000 official census found 242,325,638 Indonesians making Indonesia the world's fourth most populous country after China、India and United States. An estimated birth rate of 22.6 per 1,000 people and death rate of 6.31 per 1,000 people means that the population is growing at an annual rate of 1.63 percent. The United Nations Development Program predicts that the population will reach 250.4 million by 2015. Like many developing countries, Indonesia has a young population, with 30.6 percent of its people under the age of 15.

With the huge population, Indonesia has a greater labor pool to choose from. In addition, it also provides a larger market for the MNC (Multinational Corporation) to expend their market and sell the goods it produces in Indonesia. So the fourth largest population position in the world will be considered as a positive factor in attracting foreign investment.

4.2.4 Average Hourly Wage

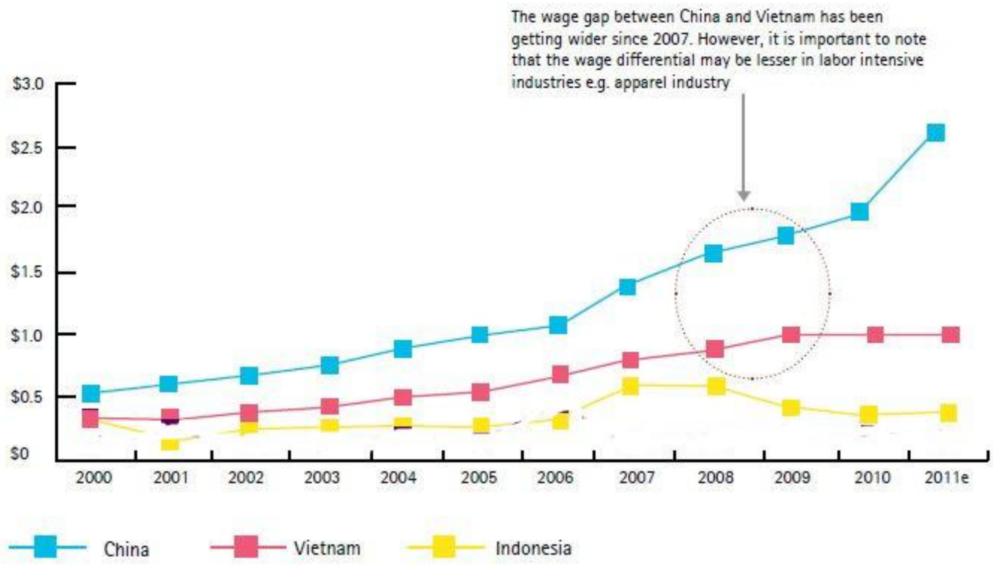

Figure 4-4 Average hourly wage, China vs. Vietnam, Indonesia and India (US$ per hour)

Global companies already have been facing higher labor prices in China over the past year, despite a weak global economy, as workers demand a greater share of the country's economic boom. In recent months, the pressure also has intensified in countries across Southeast Asia that have marketed themselves as alternatives for companies seeking to escape China's rising costs, leaving those companies now with fewer places to move. From the chart, we can see the average hourly wage in Indonesia is below USD 0.5 per hour which is much lower than the wage in China and Vietnam. With no doubt that MNCs are considering Indonesia as their potential destination for looking for new business opportunities.

4.2.5 Infrastructure Condition

World Rank

Vietnam 123

China 69

Indonesia 82

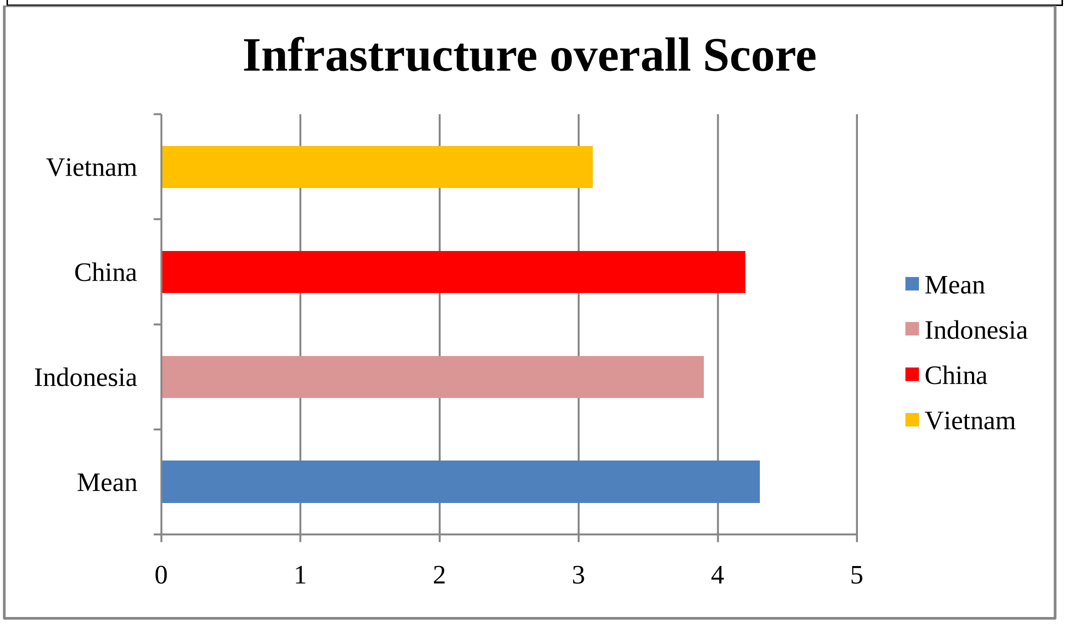

Figure 4-5 Quality of overall Infrastructure

Source: The Global Competitiveness Report 2011-2012, World Economic Forum.

Note: [1 = extremely underdeveloped; 7 = extensive and efficient by international standards]

According the chart above, we can see in the Infrastructure overall 2010-2011, Indonesia got 3.9 score, China got 4.2 score, Vietnam got 3.1 score and the mean is 4.3. All of the three countries are below the world mean.

Extensive and efficient infrastructure is critical for ensuring the effective functioning of the economy, as it is an important factor determining the location of MNCs. Well-developed infrastructure reduces the effect of distance between regions, integrating the national market and connecting it at low cost to markets in other countries and regions. In addition, the quality and extensiveness of infrastructure networks significantly impact economic growth and reduce income inequalities and poverty in a variety of ways. A well-developed transport and communications infrastructure network is a prerequisite for the access of less-developed communities to core economic activities and services. Effective modes of transport, including quality roads, railroads, ports, and air transport, enable entrepreneurs to get their goods and services to market in a secure and timely manner and facilitate the movement of workers to the most suitable jobs. Economies also depend on electricity supplies that are free of interruptions and shortages so that businesses and factories can work unimpeded.

Table 4-1 Main indicators of Infrastructure

NO	Indicators	Country	Mean	Score	World rank
1	Quality of road	Indonesia	4.0	3.5	83
		China		4.4	55
		Vietnam		2.6	123
2	Quality of railroad	Indonesia	3.1	3.1	52
		China		4.6	22
		Vietnam		2.5	71
3	Quality of port	Indonesia	4.3	3.6	103
		China		4.5	56
		Vietnam		3.4	111
4	Quality of airport transport	Indonesia	4.7	4.4	80
		China		4.6	72
		Vietnam		4.1	95
5	Quality of electricity supply	Indonesia	4.5	3.7	98
		China		5.5	49
		Vietnam		3.3	109

Source: The Global Competitiveness Report 2011-2012, World Economic Forum.

Note: [1 = extremely underdeveloped; 7 = extensive and efficient by international standards]

Indonesia’s infrastructure, ranked 82nd, requires improvements across many areas. It is well behind more advanced ASEAN members Singapore (2nd), Malaysia (23th), and Thailand (47th), and also less developed than China (69th). Other countries that also face infrastructure inadequacies are Vietnam (123rd), India (86th). All large Asian economies are experiencing rapid economic growth, massive urbanization, a rising middle class, and increased openness to trade. These trends increase the demand for infrastructure and strain that which already exists, creating bottlenecks and highlighting existing shortages. For instance, the number of vehicles in Indonesia quadrupled over the past decade to reach 11.3 million. At the same time, by some estimates, 40 percent of the population remains without access to electricity, and the demand for it increases by 8 percent a year.

The insufficient supply and quality of transport, energy, and telecommunications infrastructures seriously limit Indonesia’s output capacity. The manufacturing and export sectors particularly suffer as this state of affairs translates into limited connectivity and handling capacity, high costs, delays in shipments, and production loss.

Demand for infrastructure grows proportionally with the economy. In order to meet this demand, investment must therefore increase. In addition, the costs of maintaining and upgrading existing infrastructure should not be underestimated. Unfortunately, Indonesia suffers from a protracted lack of investment in this area. Further, the geography and the tropical climate of this country of some 17,000 islands provide a challenging environment for infrastructure deployment. It is important to note that the assessment has been improving over the years, with a gain of 0.7 since 2006 in the pillar, thanks to significant improvements in several of its components. Yet Indonesia has been losing ground in relative terms, falling from the 78th to 82nd position in the infrastructure pillar, given that other countries are moving more quickly to improve their infrastructure The situation of Indonesia is not an isolated case, and its performance is largely in line with the Developing Asia region and the lower middle income group averages. Many developing countries struggle to add infrastructure capacity to meet the needs of their booming economies. Looking at the different modes of transport, Indonesia ranks a low 83th for the quality of its roads. The World Bank estimates that only 55 percent of Indonesian roads are paved compared with an average of 80 percent for Malaysia, the Philippines, Thailand, and Vietnam as a group.

Ports in Indonesia also require improvements. They are ranked a low 103th, compared with China (56th). This is of particular concern given the country's dependence on water transport. Even Cambodia ranks higher at 82nd, despite its more basic stage of development.

As for the state of the country's railroad infrastructure, it is equally mediocre. Among the four main transportation modes, air transport infrastructure is the only one that stands out positively with a score of 4.4, despite a middling rank of 80th. Airlines in Indonesia have been adding capacity at breakneck pace, with Indonesia now the 21^{st} largest market when measured in terms of available seat kilometers. Inadequate energy infrastructure is also holding back the country's competitiveness. The business community has indicated increasing concern about the poor reliability and shortages that characterize the network. Indonesia is ranked 98th in this indicator with a score of 3.7. The situation has been deteriorating over the years, as the state power company, which operates 85 percent of generating capacity and has a monopoly on transmission and sales, has struggled to meet demand. The government is stepping up its efforts to improve power supplies. A law introduced in 2009 allows private investors and local authorities to generate, transmit, and sell electricity without having to work with the state firm.

Indonesia's infrastructure requires improvements across many areas such as improvement in road, port and electricity supply to attract more foreign retail companies invest in Indonesia.

4.2.6 Government Bureaucracy

Bureaucratic Reform Lags behind Political Reform

Jakarta, Kompas – Reform in the field of bureaucracy is lagging behind compared to reforms in politics, economy, and the legal system. Inefficient government bureaucracy is one of the primary obstacles in running business activities in Indonesia.

The government is judged incapable of providing quality public service in accordance with the challenges faced.

"As the needs of an advancing society grows and global competition becomes increasingly tighter, the government has not been able to provide first-rate services for investors who are doing business or will do business in Indonesia," EE Magindaan, Minister of State Administrative Reforms, said that during a socialization event of bureaucratic reform to provincial government officials in Jakarta on Monday (19 September 2011).

Bureaucratic reform is necessary because corruption, collusion, and nepotism have become rampant. Although many improvements have been made, Indonesia's corruption perception index is still low compared to other Asian countries.

Accountability of agency performance needs improvement and be more result-oriented. The management of state apparatus human resources is still unprofessional in matters such as discipline or adherence to regulations.

"The meaning of bureaucratic reform is a major change in the paradigm and governance of the Indonesian government. This is a big gamble for the Indonesian nation entering the 21st century. If this succeeds, it will reduce, or even completely abolish, every abuse of public authority. If we have a good bureaucracy, the quality of public service will increase, and so will the quality of policy formulation and implementation, which will be more efficient in terms of time and cost. Our bureaucracy will become more anticipative, proactive, and effective," Mangindaan said. [35]

Examples

Two provincial governments were taken as examples of governments that have implemented bureaucratic reform; namely, West Java, and West Nusa Tenggara. West Java Province Regional Secretary, LexLaksmana, explained that West Java Provincial Government has utilized and developed information technology for the process of governing management by developing a procurement service unit

[35]http://indii.co.id/news_daily_detail.php?id=1612

electronically; regional financial reporting information system, regional assets database system, and a paperless office (system) will be gradually implemented.

Meanwhile, West Nusa Tenggara Province Regional Secretary, H Muhammad Nur, said regulations, supervision, accountability, excellent service, paradigm, and work culture. (LOK that West Nusa Tenggara takes tactical steps by implementing a comprehensive change in the aspect of state apparatus utilization. This covers eight areas of change; namely, appropriate and proportional organization, procedures such as systems and process-procedure, truthful apparatus (human) resources, orderly)

Table 4-2People's reports on public services in a number of agencies

Reported Agencies	**Number of Reports**	**Percent Share**
Local Governments	354	31.13%
Police	241	21.20%
Court Institutions	155	13.63%
National Land Agency	98	8.44%
Ministries	90	7.92%
BUMN/BUMD (SOEs/Local Government Enterprises)	63	5.54%
Attorney General	41	3.61%
Indonesian Armed Forces (TNI)	16	1.41%
Banks	15	1.32%
State Commissions	12	1.06%
State Universities	12	1.06%
Government Agencies	11	0.97%
NON-MINISTERIAL		
House of Parliament	2	0.18%
Others	29	2.55%
TOTAL	1,137	100%

Notes:

The substance of the problems that people often complain about concerning public services in a number of institutions listed the above include:

-Protracted delays 50.31%

-Abuse of authority 16.97%

-Biased/not impartial 10.99%

-Deviation from procedure 7.67%

-Not competent 4.49%

-Demand for money, goods, and services 3.96%

-Inappropriateness 2.99%

-Not providing services 2.64%Source: Research and Development Division of Kompas/Yoh, processed from 2010 Fourth Quarter Report (January-December) as published on the website of the Ombudsman of the Republic of Indonesia

4.2.7 Inflation

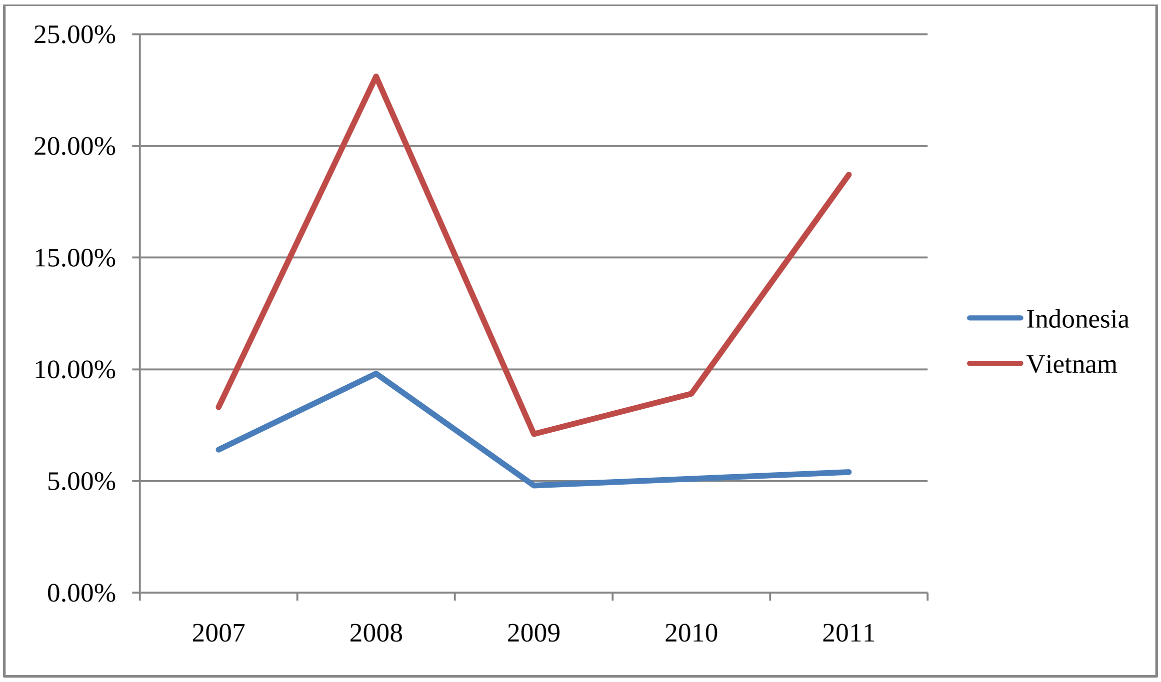

Figure 4-6 Inflation, Consumer Price Index (annual %)

Source: Data World Bank

In 2011, Vietnam's inflation rate reach 18.8% ranked 18th in the world, and Indonesia's inflation rate hit 5.2% ranked 83th among 221 countries. Low inflation is taken to be a sign of internal economic stability in the host country. High inflation indicates the inability of the government to balance its budget and the failure of the central bank to conduct appropriate monetary policy. Lower inflation coupled with other factors such as high economic growth can attract foreign investors and increase the FDI inflow into Indonesia.

From this figure we can see that compared the inflation with Vietnam, Indonesia is better than it. For the foreign investors, this is good news. In the researcher's opinion, I could say this is a potential factor.

4.2.8 Corruption

Table 4-3 Corruption Perceptions Index 2010

Rank	Country	Score
1	Singapore	9.3
56	Malaysia	4.4
78	Thailand	3.5
78	China	3.5
110	Indonesia	2.8
116	Vietnam	2.7
134	Philippines	2.4
154	Laos	2.1
154	Cambodia	2.1

Source: Transparency International

The 2010 Corruption Perceptions Index show that nearly three quarters of the 178 countries in the index score below five, on a scale from 10 (highly clean) to 0 (highly corrupt). These results indicate a serious corruption problem.

Table 4-4 Corruption Perceptions Index 2011

Rank	Country	Score
5	Singapore	9.2
60	Malaysia	4.3
75	China	3.6
80	Thailand	3.4
100	Indonesia	3
112	Vietnam	2.9
129	Philippines	2.6
154	Laos	2.2
164	Cambodia	2.1

Source: Transparency International [36]

The 2011 Corruption Perceptions Index shows that public frustration is well founded. No region or country in the world is immune to the damages of corruption, the vast majority of the 183 countries and territories assessed score below five on a scale of 0 (highly corrupt) to 10 (very clean).

The Corruption Perceptions Index ranks countries/territories based on how corrupt their public sector is perceived to be. A country/territory's score indicates the perceived level of public sector corruption on a scale of 0-10, where 0 means that a country is perceived as highly corrupt and 10 means that a country is perceived as very clean. A country's rank indicates its position relative to the other countries/territories included in the index. Here the researcher just chose 8 southeast countries and China; show their rank all over the world.

From these two tables that we can see, Indonesia scored 2.8 in 2010's CPI (Corruption Perceptions Index), and scored 3 in 2011, it is a slight increase on last year's score. Indonesia ranked 110 out of 178 countries in 2010 and 100 out of 183 countries in 2011. What I want to say is there is no one country around the world that does not have corruption, even in USA and China, corruption is also existed. As a business student, I totally understand why corruption is existed all over the world. So about this factor, compared the corruption perceptions index 2010 and 2011 of Indonesia, I think even though the rank of CPI of Indonesia is increasing a little, but the problem is still existing, and still influencing the foreign retailer's decision, so this is considered as a negative factor.

[36] http://www.transparency.org/cpi2010/results

4.2.9 Labor Force

Table 4-5 Labor Force –by Occupation (%)

Country	Agriculture	Industry	Services
China	36.7	28.7	34.6
India	52	14	34
Indonesia	38.3	12.8	48.9
Thailand	40.7	13.2	46.1
Vietnam	48	22.4	29.6

Source: Salary Explorer[37]

This entry lists the percentage distribution of the labor force by sector of occupation. Agriculture includes farming, fishing, and forestry. Industry includes mining, manufacturing, energy production, and construction. Services cover government activities, communication, transportation, finance, and all other economic activities that do not product material goods.

From this table we can see, these five countries are all developing countries, agriculture has an important position in its economy structure, especially India. But in the service area, Indonesia is better than other countries, up to 48.9%, it has a vital position for Indonesia economy. According to my own experience, I think this is a good factor for retailers. So the researcher supposes this should be a positive factor.

[37]https://www.cia.gov/library/publications/the-world-factbook/fields/2048.html

4.2.10 GDP-per capita (PPP) (US$)

Figure 4-7 GDP-per capita

Source: CIA World Factbook

Definition of GDP-per capita (PPP): this entry shows GDP on a purchasing power parity basis divided by population as of 1 July for the same year.

From this chart we can see, for the last five years, the GDP per capita is been increasing, that means people have more income at hand, they have potential to buy what they need, so for the retailers, they can provide more products and services for the residents.

CHAPTER V

CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusions

The retail sector has played a phenomenal role throughout the world in increasing productivity of consumer goods and services. There is no denying the fact that most of the developed economies are very much relying on their sector as a locomotive of growth. The retail industry in Indonesia has come forth as one of the most dynamic and fast pace industries with several players entering the market.

The objective of this thesis is trying to find out the potentials and challenges for foreign retail companies in Indonesia. Based on the previous analysis and interpretation, the researcher found that there are seven positive factors that influencing foreign retail companies who intend to do business in Indonesia are:

1) Annual GDP
2) GDP-real growth rate
3) Human Capital
4) Average Hourly Wage
5) Low Inflation
6) Rich Labor Force
7) GDP-per capita

However this research also shows that there are the negative factors which any foreign retailer should consider before entering the Indonesian market, they are:

1) Inefficient Government Bureaucracy
2) Poor Infrastructure Condition
3) Considerable level of Corruption Practices

5.2 Recommendations

Based on the analysis in chapter 4 we know, inefficient government bureaucracy, poor infrastructure, and corruption are the negative factors that will influence the foreign retail companies invest in Indonesia. As the needs of an advancing society grow and global competition becomes increasingly tighter, the government must be able to provide first-rate services for investors who are doing business or willing to do business in Indonesia. So the bureaucratic reform is necessary to do.

As we know, corruption is a big problem for Indonesia government, for the foreign retail companies, of course they do not like to do business in a corrupt country, because this will increase their cost, and they will transfer this cost to the consumers, at last, the residents are the victims. But the researcher also knows the Indonesia government has established Corruption Eradication Commission (KomisiPemberantasanKorupsi) since 2002, the aim of this institution is to fight corruption. In the past ten years, this agency has made a lot of contribution to the Indonesia government, but still not enough, so in the future years, the Indonesia government must work harder on corruption, in order to attract more foreign investors.

Poor infrastructure is also a big challenge for the Indonesia government. Some analysts pointed out that infrastructure had become the top obstacle to do business in Indonesia. Roads, port and airport are inadequate. Electricity generation lags demand, etc. so the Indonesia government has to pay more attention on the infrastructure. To attract more foreign retail companies to do business in Indonesia, they must improve the infrastructure immediately.

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