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Approved by:

Ross Kreamer
U.S. Consulate

Prepared by:

Lauren Buckalew

Report Highlights:

Shanghai is undisputedly the largest market in China for imported U.S. wines. In 2004, the U.S. was the third largest importer of bottled wines by volume, after France and Australia. As the up-and-coming financial center of Asia, Shanghai is now home to a clutch of exclusive 5-star restaurants, wine bars, boutiques, and supermarkets that sell imported wine to foreigners and increasingly to locals as they become more educated about wine. A large potential market for wine in China remains: with relatively low per capita consumption of domestic wines, and even less of imported wines, this market has room for growth.

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“In Vino Veritas!”

Shanghai is undisputedly the largest market in China for imported wines and imported U.S. wines. In 2004, U.S. winemakers shipped 3,634 KL (MT) of wine to Shanghai (Shanghai Customs). As the up-and-coming financial center of Asia and the keystone to massive foreign investment in the Yangtze River delta, Shanghai is now home to a clutch of exclusive 5-star restaurants, wine bars, boutiques, and supermarkets that sell imported wine to foreigners and increasingly to locals as they become more educated about wine. Wine-producing countries such as France and Italy that have been on the market for years have high recognition amongst Shanghainese, but in blind taste tests consumers prefer U.S. wines' fruitier, fuller flavor. A large potential market for wine in China remains: with relatively low per capita consumption of domestic wines, and even less of imported wines, this market has room for growth, if winemakers have the patience and perseverance to market their wines over the long-term.



The China Wine Market

General

China's total retail sales of wine for 2003, the latest year statistics are available, were \$7 billion (Euromonitor). Anecdotal evidence suggests that 70% of wine sales in China occur in restaurants and bars; however, no official figures are available for HRI sales volume or value. 2004 imports of wine (sparkling, white and red) were valued at \$52.8 million, up 58% from 2003. Imports of U.S. wine accounted for 7% of the 2004 total. From 2003 to 2004, U.S. imports increased 118% in value to \$5.37 million, and 76% in volume, to reach over 2,000 KL (FAS trade data, World Trade Atlas)¹.

China is a wine-producing country, with over 500 wineries in operation—10 or so of which are major producers—in China's northeast and in its far-flung western province Xinjiang. Modern commercial Chinese viticulture began only in the past 30 years, with the opening of China's economy. Joint ventures with foreign wine companies, notably between Illva Saronno SpA, Remy Cointreau, and major players Changyu, Dynasty, and Imperial Court have helped China's wineries procure vines, improve production technology, and use foreign expertise.

Quick Facts

- 88% of the wine imported from the U.S. in 2004 was bottled (FAS)
- In 2004, the U.S. was the third largest importer of bottled wines to China, after France and Australia, by volume (World Trade Atlas)
- In blind taste tests, Chinese prefer the taste of U.S. wines over those of France
- Next trade show in Shanghai featuring wine: SIAL, May 18-20, 2005

¹ This report uses data from the USDA's Foreign Agricultural Service (FAS) and China Customs as reported in the World Trade Atlas (WTA). FAS and China Customs records vary widely on U.S. export data for China. Counterfeit U.S. bulk imports, which make U.S. bulk wine imports appear larger than they are, may be one reason. In this report, FAS data is used for U.S. statistics, and China Customs data is used for information on all other exporting countries. For more details on the differences in reporting please see Appendix A.

Domestic brands dominate the large, price-sensitive segment of the Shanghai market. The major domestic brands in Shanghai—Changyu, Great Wall, Dynasty, and Imperial Court—retail at around \$4 a bottle, making them attractive choices for consumers who cannot afford imported wine, which averages around \$12.

The Region

China's Yangtze River Delta, which includes Shanghai and its prosperous satellite cities in Jiangsu Province to the north and Zhejiang Province to the south, is a key consumer market. Shanghai residents have the highest per capita disposable income in China at US\$1,800 per year, and residents of nearby cities are not far behind, with disposable incomes in major cities ranging from \$1,600 (Zhejiang Province) to \$1,200 (Nanjing, Jiangsu) a year (China Statistical Yearbook 2004). Shanghai's 21 million residents especially enjoy new foods and flavors, and it leads the nation in food and restaurant trends.

As the middle class expands and incomes rise, consumption of non-essential, high-value products such as wine will rise as well. In 2003 the per capita retail wine sales in Shanghai were second in the nation at 7.39 RMB (\$0.89), and in Zhejiang Province fourth highest at 6.03 RMB (\$0.73) (Access Asia). When comparing the price per unit consumed, it becomes clear that Shanghainese are buying more high-end (imported) wines per capita than consumers in other provinces, with Zhejiang not far behind (see ratios in Table 1 below). Tianjin, the city with the highest volume of consumption nation-wide, is something a red herring; most of the sales are of cheap domestic wines.

Table 1: Values and Volumes of Wine Consumption Per Capita, Select Provinces, 2003

| Province | Value (RMB)* | Volume (Liters) | Ratio Value: Volume |
|------------------|--------------|-----------------|---------------------|
| Shanghai | 7.39 | 0.27 | 27.37 |
| Beijing | 9.27 | 0.35 | 26.49 |
| Guangzhou | 5.13 | 0.24 | 21.38 |
| Zhejiang | 6.03 | 0.31 | 19.45 |
| Jiangsu | 1.95 | 0.12 | 16.25 |
| Tianjin | 6.24 | 1.70 | 3.67 |
| National Average | 2.57 | 0.20 | 12.85 |

*\$1.00=RMB 8.27

Access Asia

Imported Wines: High Hopes for the High-end Market

In 2004, China imported almost 7,500 KL of bottled sparkling and table wine, and 36,600 KL of bulk wine (WTA). Imported bottled wines set the standard for the high-end market, competing not only with expensive domestic wines, but also with equally pricey imported spirits such as VSOP and Hennessy. Competition among exporting countries for the limited high-end niche is fierce, with France and Australia in the lead in the bottled wine market. Chile has supplanted Spain as the dominant bulk exporter, having achieved and maintained the highest export volume of all countries to China since 2001. Imported bottled wines comprise less than 1% of the total retail market, due to the enormous volume of domestic

wine available (Euromonitor).² Imported wine’s largest market in Shanghai is the hotel and restaurant industry, including nightclubs. Shanghai’s 4- and 5-star hotels, western restaurants—from 2-star to world-class—and up-scale local chain restaurants targeting Shanghai’s middle and upper classes all carry imported wines. Some local chain restaurants also feature private label imported wines.

U.S. wine exports have increased five-fold in value from \$1.5 million in 1999 to \$5.373 million by 2004. Exports are increasingly bottled, up from 690 KL in 1999 to 1,800 KL in 2004, while bulk shipments have actually declined (FAS). However, due to their late entry, U.S. winemakers have not yet gained a significant market share relative to their French and Italian counterparts, nor relative to other latecomers such as Australia or Chile. Chilean wine imports (mostly bulk, mixed with and sold as Chinese wines) had the highest value of all countries in 2004, at \$20 million, followed by French (\$14.2 million) and Australian (\$6.3 million) wines, respectively (WTA).

At present, imported wines’ largest market is on-trade, in up-scale restaurants, bars, and exclusive nightclubs. Shanghai’s Xin Tian Di (pronounced “shin tyen DEE”), a complex of carefully assembled up-market bars and restaurants frequented by locals and foreigners, is one such venue. Bars and restaurants in Xin Tian Di and similarly up-scale locations buy wines at wholesale for around \$7.50 per bottle, not including tariffs (the price including tariffs is around \$12). After adding their own profit margins, wines in this price range sell well to Xin Tian Di’s customer base, mostly white-collar locals. Of course, higher- and lower-end wines are also on the menu, from \$15 Chilean to \$1,000+ French.

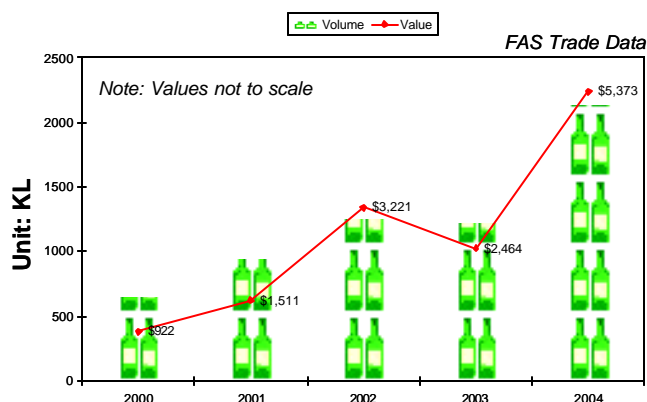
Given a growing interest in retail imported wines, wine retail chains could see a new market in Shanghai in the near future. Xin Tian Di now features a new wine and cheese store, and wine-and-cheese specialty shops are opening in other high-end retail shopping areas.

Marketing in a New Culture

One would be hard-pressed to find a commodity with a more positive image in China than wine, which is associated with sophisticated western customs, the social elite, and health.

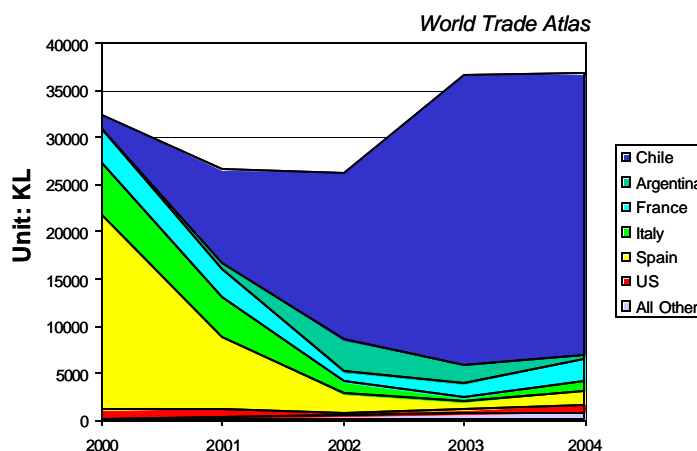
² Does not factor in the amount of imported bulk wine that is mixed with Chinese wine and labeled as “domestic”, even if it is actually 35-45% from foreign grapes.

Chart 1: U.S. Wine Exports to China



No cause for sour grapes: despite a slower year in 2003, U.S. wine exports have rebounded to achieve new highs.

**Chart 3: Bulk Wine Exports to China, 2000-2004
Major Exporters Past and Present**



“C” change: within just the last 4 years, Chile has come to dominate the bulk wine imports market.

Yet although this image of wine has been popularized, in the beginning wine education—how to appreciate fine wine—did not follow behind with equal strength or pervasiveness. A compounding factor is the government’s very loose regulation on appellation and grape varieties, making Chinese wine labels less meaningful to consumers. Although the wine industry has debated using the French or German system of classification, no decision has been made (China Wine Online).

Without a grape wine tradition of their own, Chinese initially integrated wine into the local drinking culture as a healthy, new, lower-cost alternative to other high-end drinks such as imported brandy or Chinese spirits. At present, wine purchases by local Chinese fall largely into two categories: banquet dinner purchases and retail gift purchases. In neither case does the buyer buy wine for himself; instead, wine serves as an elegant and tasteful gift to share or for others to enjoy. Banquet drinking generally involves competitive drinking among men (and occasionally including women) in a formal banquet setting in which the ordering of expensive dishes and drinks demonstrates respect for guests or superiors. Red grape wine frequently substitutes for the higher-octane clear spirits (*baijiu*) at official banquets in Shanghai, especially for toasts. Wine pairing with food is yet uncommon; most Chinese prefer red wines overall, so they tend to choose red wines for all dishes. Wine conveys the same affection and respect as a gift item, to be given on special occasions such as Chinese New Year or a housewarming party. Gift packaging in the form of a sturdy cardboard display box is standard. Larger gift boxes may include 2 bottles of wine and a corkscrew or wineglass, all resting on a “satiny pillow” (a plastic mold covered with attractive fabric).

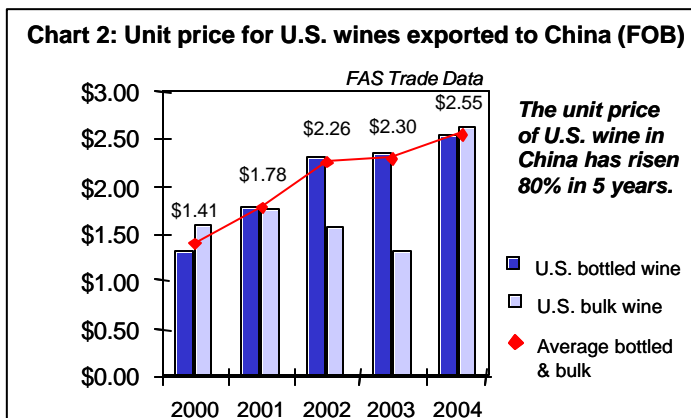
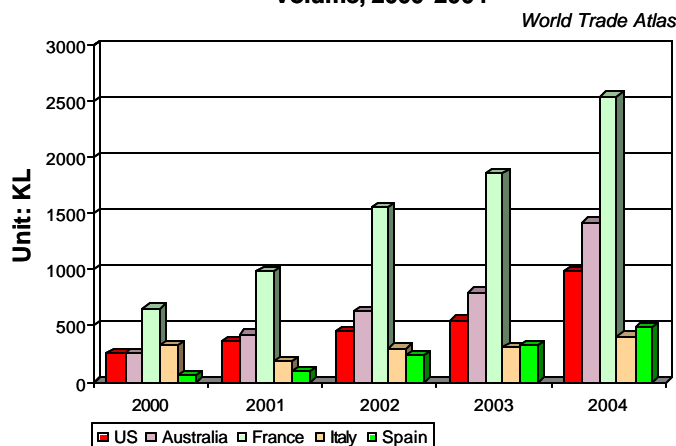


Chart 4: China: Top Bottled Wine Suppliers Volume, 2000-2004



Ooh la la: in a gift market where image is everything, French bottled wines remain in the lead thanks to years of strong marketing.

Chinese wine drinking habits have been known to differ from those in the west. Some differ enough to horrify those righteous wine aficionados unfortunate enough to witness them—wine can be gulped like a shot, or mixed with lemon, ice, or Sprite. Due to Shanghai’s long-time foreign presence, influence, and resulting familiarity with wine, local wine lovers are gradually taking up western wine drinking practices. For the most part, however, ordinary Shanghainese and their compatriots in nearby cities will continue to mix or dilute wine to achieve a sweeter taste. As one distributor commented, “No one likes the taste of wine the first time.”

Even as Chinese consumers gradually assume western wine consumption habits, there are some differences in the market that will remain for the foreseeable future:

- 75-80% of the wine consumed in Shanghai, and across China, is red wine. This could be due to positive media on red wine's health benefits. Interestingly, in blind taste tests, Chinese prefer white; however, because of wine's function as a symbolic gift and not for personal consumption, red wine sales should continue to be strong. White wine sales tend to be to foreigners who are attuned to food pairing, and thus choose white when it suits the meal; and to local women, who claim that white wine is lighter. Also, white wine sales during the summer increase significantly because it can be enjoyed chilled.
- Shanghainese prefer the fruitier, fuller tastes of U.S. wine. 65% preferred the taste of California wine in a blind taste test against French, Chinese, and Australian wine. However, they all associated it with French wine, indicating a lack of awareness of U.S. wines. Because purchase behavior is so strongly linked with wine's image, to succeed in the local market U.S. exporters need to promote their product image as quality, prestigious wine.



State-owned tobacco and liquor store in Shanghai. Very few if any US wines are sold in these stores. Whether foreign wine retailers will enter the market is yet to be seen.

Lastly, access to mainstream, middle-class Shanghainese is a long-term goal. Current sales of imported wine are limited largely to foreigners and upper-income urban Chinese. Distributors in Shanghai cite strongest sales in up-scale and/or western bars and restaurants; supermarkets frequented by expats; home delivery to foreigners; and corporate or free-flow events. Online sales are also on the rise. As incomes rise, and as more Shanghainese become familiar with imported wine and learn to enjoy the taste, imported wine consumption will increase, in bars and restaurants (western and Chinese) and in retail.

Marketing Assistance

Introducing a foreign wine and creating a brand and product that suits Chinese consumers takes commitment and smart marketing. The Agricultural Trade Office/Shanghai, one of four FAS offices located in China to provide marketing support for U.S. companies, provides country market information and market development support, and conducts a wide variety of activities designed to build distribution channels for U.S. agricultural products. The ATO is a good place to start for a winemaker who is interested in the China market and needs expert, in-country advice.

ATO often works with cooperators including the California Wine Institute (WI) and the Oregon Wine Board to promote U.S. wine in the Shanghai area. Events such as wine tastings for trade professionals, wine dinners, and trade shows are typical ways to introduce wines to hotel and restaurant buyers and distributors. (France and Australia, for example, have consistently installed pavilions at trade shows to feature their wines; today they have the highest market shares for bottled wine.) Consumer wine tastings have become so prevalent, however, that unless the product is very unique or a famous brand, returns are minimal. Establishing a brand is a long-term process, and unless properly focused, the results are

difficult to quantify. ATO is happy to work with wineries new to the market to develop custom programs to test market their wines with distributors.

To increase market awareness directly among end users, ATO's large umbrella events for U.S. products, such as restaurant and retail store promotions, and the multi-product Chinese New Year promotion in mid-winter are good places to begin. To get more bang for their buck, wineries from a particular regional appellation are encouraged to work together to establish a market image for the region. Those who would like first-hand experience with the China market are encouraged to visit or join a trade mission.

Distributors, Import Laws and Regulations

The first step in exporting bottled or bulk wines to Shanghai is to find a good distributor. Although the major wine distributors/importers offer impressive lists of imported labels, most currently do not proactively market new wines. That said, an interested importer/distributor will be able to explain tariffs and labeling requirements, help a seller quickly register wine so it can be imported, and help import small quantities hassle-free for trade shows and tastings. With the help of your distributor, arranging annual visits to current and potential buyers in China are very effective ways of staying visible on the market. A detailed list of wine importers and distributors in the area can be provided upon request.

Imported wine is subject to a total import tax of 48.2% for sparkling and still wines in containers less than 2 liters (bottled table wines), and 56% for wine in containers over 2 liters (bulk wine)³. The current tariff levels are expected to remain constant for the near future, although if imported wine begins to overpower the domestic wine market, the government may raise the consumption tax to level the playing field. Imported U.S. wines are retailing on average at 130-300 RMB (\$15.50-\$36) a bottle, but shipping bulk and bottling in China can significantly lower retail prices to 38-70 RMB (\$4.85-8.50) per 750 ml bottle.

China's Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) labeling requirements for imported wine require that certain product information on the bottles be in Chinese (see Appendix B, List of Product Information Required in Chinese). At present, the distributors for many foreign wineries are sticking small, printed adhesive labels over their back labels, leaving the unique and artistic front labels untouched. Although AQSIQ has been accepting the stickers, in future the Administration is expected to be firmer in requiring permanent labels in Chinese.

³ The formula used to derive the total import tax and covering the customs tariff, VAT, and consumption tax, is provided in Appendix C.

Useful Contact Information

U.S. Agricultural Trade Office Shanghai
 Mr. Ross Kreamer, Director
 Suite 331, Shanghai Center
 1376 Nanjing West Road
 Shanghai CHINA 200040
 Tel: +86 (21) 6279-8622
 Fax: +86 (21) 6279-8336
atoshanghai@usda.gov

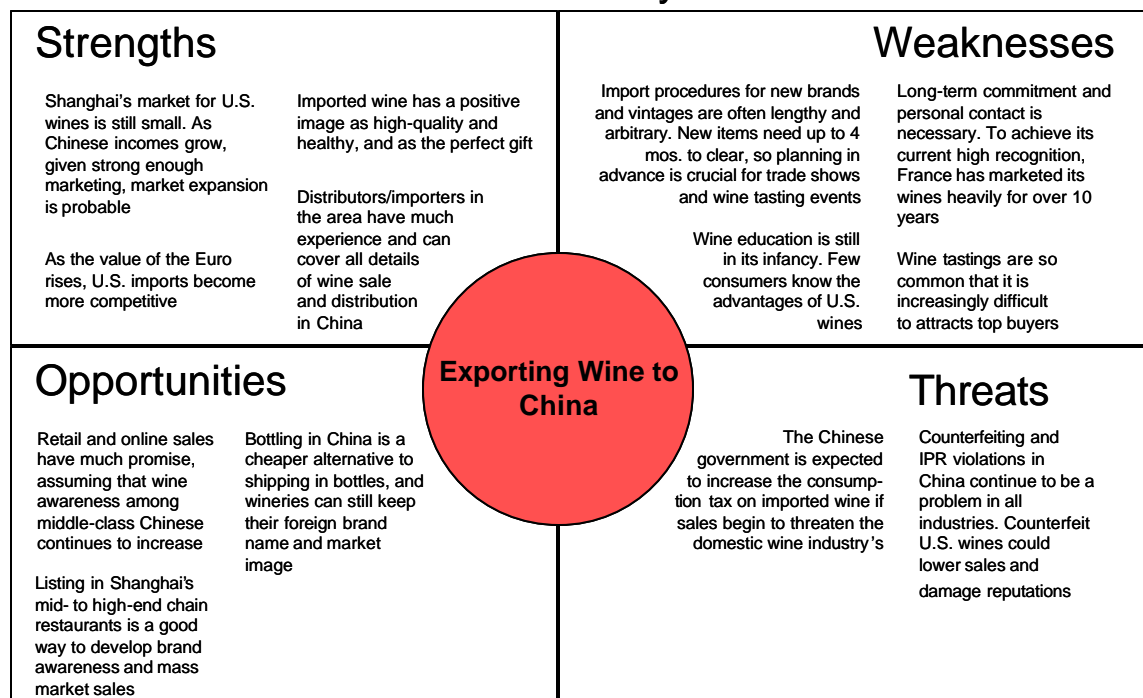
California Wine Institute
 Barbara Lee
 Room 3A, 3rd Floor
 886 Tianbao Road
 Shanghai, CHINA 200086
 Tel: +86 (21) 5557-0142
 Fax: +86 (21) 6515-6498
leesmarket@sh163.net

Oregon Dept. of Agriculture
 Brian Liu, International Trade Manager
 1207 NW Naito Parkway, Suite 104
 Portland, OR 97209-2832
 Tel: (503) 872-6600
 Fax: (503) 872-6601
bliu@oda.state.or.us

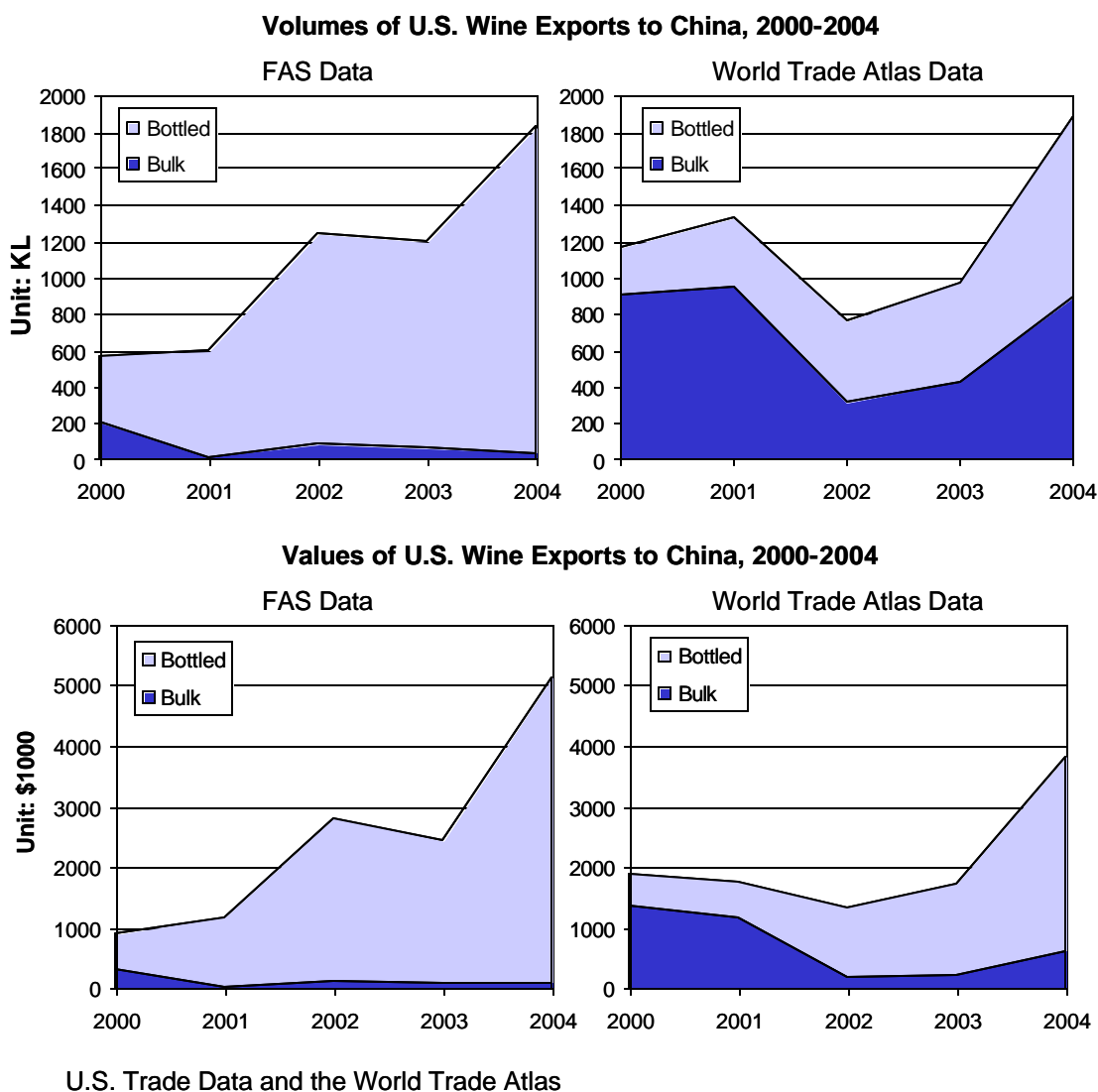
Washington State Dept. of Agriculture China Office
 Li Haidong
 15F Aile Building, No. 631 Lingling Road
 Shanghai, CHINA 200030
 Tel: +86 (21) 5424-4336
 Fax: +86 (21) 6489-9665
lhaidong@163.net

SWOT Analysis

SWOT Analysis



Appendix A: Discrepancies between U.S. and China Data



Appendix B: List of Product Information Required in Chinese

- A. Name/Brand
- B. Ingredients
- C. Net volume (ml)
- D. Alcohol content (%)
- E. Production place
- F. Production date (yy/mm/dd)
- G. Packer/distributor/importer (Name and address)
- H. Must content (%)
- I. Country of origin
- J. Quality guarantee or storage period (yy/mm/dd)
- K. Sugar content (g/L)

Appendix C: Formula to Determine Import Tax on U.S. Wine

Total import taxes for bulk and bottled wine factor in an import tax, consumption tax, and VAT:

| | |
|----------------------------|-----|
| Import tax rate (ITR) | |
| Bulk wine | 20% |
| Bottled wine | 14% |
| Consumption tax rate (CTR) | 10% |
| VAT rate | 17% |

Rather than being the simple sum of these percentages, however, the total import tax is calculated using a compound formula. Using bottled wine for an example, the compound rate is calculated as follows:

$$\text{Total import tax} = \frac{\text{ITR (0.14)} + \text{CTR (0.10)} + \frac{\text{VAT rate (0.17)} + (\text{ITR (0.14)} \times \text{rate (0.17)})}{1 - \text{CTR (0.10)}}$$

Simplifying,

$$\text{Total import tax} = \frac{0.41 + 0.0238}{0.9} = \frac{0.4338}{0.9} = 0.482 = \mathbf{48.20\%}$$

Source: 2005 Customs Import and Export Tariff of the People's Republic of China

We can calculate that the total import tax on bottled wine is 48.2%, and on bulk wine is 56%.

Appendix D: U.S. Wine Exports to China, 1999-2004

| COMMODITY | HS TARIFF CODE | Value (1,000 U.S. dollars)/Year | | | | | | % CHANGE '03-'04 |
|-------------------------|----------------|---------------------------------|------------|--------------|--------------|--------------|--------------|------------------|
| | | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | |
| SPARKLING WINE | 2204100000 | 3 | 13 | 313 | 18 | 11 | 53 | 381.82 |
| EFFERVESCENT WINE | 2204212000 | 0 | 42 | 23 | 0 | 0 | 194 | -- |
| WINE, <2L, <14% alcohol | 2204214000 | 1,040 | 541 | 1,150 | 2,672 | 2,354 | 4,957 | 110.58 |
| WINE, <2L, >14% alcohol | 2204217000 | 0 | 0 | 0 | 8 | 17 | 83 | 388.24 |
| WINE, >2L, <14% alcohol | 2204290020 | 7 | 318 | 0 | 130 | 60 | 86 | 43.33 |
| WINE, >2L, >14% alcohol | 2204290040 | 0 | 8 | 25 | 0 | 22 | 0 | -- |
| | TOTAL | 1,050 | 922 | 1,511 | 2,828 | 2,464 | 5,373 | 118% |

Source: U.S. Trade Data