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Pet Food Market Overview

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Report Highlights: The commercial pet food market in China is expected to skyrocket by 60 percent by 2010 as a new culture of pet ownership sweeps middle and upper income Chinese families. With dog food leading the way, premium categories are the most attractive segments for U.S. pet food exporters. Positive consumer perception, slowly developing brand loyalty, and lack of domestic competition make this nascent market a fast-growing, but already highly competitive niche for imports.

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Executive Summary

Although pet ownership in China is still relatively small, increasing incomes are spurring the rebirth of a pet culture. Growth in the middle and upper income brackets in China assure a rapidly increasing number of pets in urban areas and pet owners switching to commercial pet foods. The prestige of pet ownership, especially dogs, among wealthy urban Chinese has led to an especially sharp increase in the demand for high-end pet food products. There are five key trends that dominate this emerging market:

Growing Pet Population

In the past five years, dog and cat ownership in China has increased by at least 30 and 16 percent, respectively. Though the cat population is growing, pet food manufacturers are targeting dog owners because they are more likely to feed manufactured pet food.

Dog Food Leading Growth

While cats had a more traditional place in Chinese urban pet culture due to their smaller size and lower food demands, dogs represent prestige. Dog ownership proves that the owner can both afford to buy an expensive animal and has the space to keep one. As a result, urban dog owners tend to spend more on dog food and pet care products than cat owners. About 35 percent of dogs are now fed commercial pet food, triple the number from five years ago.

Premium Market

While there are only a few domestic pet food manufacturers, they effectively cover the low-end pet food niches due to low cost and flexible delivery and packaging. However, imported animal food dominates the price inelastic, premium market segments. High retail prices, demand for high quality nutrition, and consumer demand for imported brand names drive import dominance of the high-end niches.

Nascent Consumer Loyalties

Due to the newness of the market and, often, people as pet owners, there is a generally low brand loyalty. The lack of consistent stocking of specific brands and types of food at many of the smaller retail stores also contributes to low brand loyalty. However, this does not mean that pet owners are not brand conscious, but that they simply have yet to develop loyalty to an individual brand. This situation presents opportunities for companies that are early to market their products and gain the loyalties of a generally highly brand conscious clientele.

Regulation of Market Increasing

An increasing challenge is the regulation of pet food products. The Ministry of Agriculture (MOA) is responsible for the regulation of pet food products. As many of these products are completely new to China, MOA's regulatory structure is not currently flexible enough to allow easy registration and import. Thus, the registration process requires time, attention, and often the help of an import agent.

Pet Population

The pet population in China is difficult to estimate due to a reluctance of many pet owners to officially register their pets. However, Euromonitor and other sources estimate that China has about 26 million dogs and 58 million cats (less than ten percent of total households own

1,000 animals	2000	2001	2002	2003	2004	2005
Dog population	20,000	22,000	23,000	23,000	25,000	26,000
Cat population	50,000	51,000	53,000	54,000	57,000	58,000
Bird population	70,000	70,000	71,000	73,000	74,000	75,000
Small mammal population	2,000	1,700	1,800	1,800	1,900	2,000

Sources: Euromonitor and Pet Food Institute

dogs and 15 percent own cats). The important picture is not only the absolute number of pets, but also the growth in pet ownership. Generally speaking, new pet owners are urban Chinese and much more likely to purchase manufactured animal feed than use table scraps.

Prior to the mid-1990's, few urban Chinese had the room to keep pets, especially dogs, and commercial food essentially did not exist. Additionally, the Chinese Government actively discouraged urban pet ownership by using a very expensive registration process. While the official registration was not always strictly enforced, the process was a hurdle to pet ownership.

Even today, some of the restrictions remain on pet ownership. Dogs over 13 inches are officially banned or severely restricted in many cities, including Beijing. Though the official registration fee has been reduced to \$200 or lower in many cities, the fee remains too expensive for most pet owners to officially register their pets. Inconsistent enforcement does not deter every potential pet owner, though the lack of registration can cause problems. For example, Chinese authorities react very harshly to an outbreak of rabies and tend to confiscate all pets without (and sometimes with) licenses.

Considering the hurdles and expenses related to pet ownership in Chinese cities, cats are the most affordable and dogs are the most expensive to maintain. Secondly, due to the rapid pace of urbanization, almost all of the growth in the pet population is in urban areas. The conclusion is that overall growth in the pet population is in the cities and that people buying dogs are likely to be wealthier. This reinforces the data that shows faster growth in dog food sales relative to the overall pet population.

	Shanghai	Zhejiang Province	Beijing	Guangzhou
Pet Clinics/Hospitals	56	55	212	112
Small Animal Veterinarians	136	230	610	446
Dog Population	600,000 (100,000 licensed)	700,000 (300,000 licensed)	800,000 (410,000 licensed)	103,000 (400 licensed)
Cat Population	300,000	350,000	200,000	22,000

Source: Pet Food Institute

Veterinarians

A secondary consideration in the pet food market is that of health care providers. Veterinarians are important because they represent one of the primary sources of information for new pet owners. Due to the high rate of animal diseases, new pet owners are very careful about checking the health of a new pet. Therefore, both first-time pet owners and new pet owners get their initial health and nutrition information from their local veterinarian.

In larger cities, the local veterinary office can often be informal, though established clinics are growing. For example, Beijing has only 212 official clinics with 610 registered small animal veterinarians. This situation poses challenges to local governments trying to regulate veterinary practitioners and monitor pet registrations. However, the growing number of clinics is important to marketing of products and is mentioned later.

There are currently 35 small animal veterinary training schools and colleges in China. The yearly enrollment is about 9,000, though only 6-7 percent of entrants become practicing veterinarians. The Chinese Government does not require veterinarians to get a license before they start practicing, but gives each province the ability to regulate the profession through examinations, checking qualifications, or inspecting the clinic's facilities.

Sales Outlets

While large retail sales outlets are gaining ground in overall Chinese sales of foodstuffs, pet food is still dominated by small stores. As Table 3 notes, small pet shops have almost 50 percent market share and are clearly the largest retail venue. These stores generally have small retail space, usually no more than 75 m². However, this categorization can be misleading due to the frequent pairing of local veterinary offices/clinics and small pet shops. Thus, there is often no real distinction between the pet shop and the veterinary office.

The close ties between the pet shop and the veterinarian is important in more than just physical proximity. As mentioned above, the local vet gives advice and information to pet owners. Therefore, cooperation with these local vets is vital to pet food companies. They provide the most solid link to customers. They are often the first and only professional that gives new pet owners advice regarding the volume and type of pet food to feed the animal. They also provide advice to existing pet owners regarding a fluid product mix in the market. As new products come to market and many existing imported products are irregularly stocked, the veterinarian provides valuable insight to pet owners. Research indicates that in large cities, 100 percent of clinic practitioners already know how to educate pet owners



Pet Food Display in Shanghai Pet Clinic

% of Total	Dog and Pet Food	Other Pet Food	Pet Care Products
Veterinary clinics	10	0	13
Pet shops	49	70	75
Pet superstores	2	0	2
Supermarkets/hypermarkets	31	2	6
Other food stores	2	0	0
Other non-food stores	5	28	4

Source: Euromonitor and Pet Food Institute

regarding the benefits of manufactured pet foods. In small cities, 85-95 percent of vets know how to use/recommend commercial pet food.

The pet shop is also often associated with the growing number of Western-style pet clinics. These clinics are often much more expensive than the local vet because they provide more services and have better quality pet care and diagnostic equipment. The rise of veterinary clinics provides an even better opportunity for pet food manufacturers because the clientele would most likely be the most affluent of pet owners. Thus, the veterinarians would be most open to recommending high-end nutritious pet products because their clients would not only demand the best for their pet, but they would also be able to afford it.

As in many Western countries, supermarkets and pet superstores are gaining a larger share of the pet food and supply sales in China. Consistent stocking of brand names, a wide selection, a variety of price levels, and convenience will slowly draw pet food shoppers away from the other outlets as more Chinese make their primary food purchases in these places.

Lastly, one of the markets expected to remain stable on the lower price categories is the sale of loose pet food in markets and other non-traditional pet food outlets. As middle and lower-middle income people become pet owners and buy commercial pet food to supplement or replace some table scraps, they are most likely going to purchase pet food in or near the local markets where they buy fresh fruits and vegetables. These will likely be small quantities, often loose. This poses a challenge in terms of packaging, branding, and counterfeiting of merchandise.

Another important factor in examining sales outlets is co-marketing of animal care products. Animal care products are even newer to China than commercial pet food, so the pet food is often a draw to these pet care products. The key pet care products are cat litter, dietary supplements, and grooming supplies. Groomers and grooming supplies are growing rapidly, but from a small base.

Pet Food Products and Retail Sales

The biggest change, as a result of the pet revolution in China, is the number of animals being fed commercial feed. This change is fueling the rapid growth in the number of outlets, types, and categories of pet food. A fundamental factor supporting this trend is the percentage of pets eating commercial food, shown in Table 4. The percentage of dogs eating commercial food rose from 17 percent to 35 percent and the number of cats rose from 12 to 19 percent. More importantly, the total number of dogs eating commercial food rose from 3.5 million to 9.1 million, while the number of cats increased from 6.1 to 11.0 million.

According to the Pet Food Institute, dry food accounts to about 60 percent of all commercial

	2000	2001	2002	2003	2004	2005
Dogs	17.4	24.5	26.2	29.8	34.3	35.0
Cats	12.3	13.1	14.2	15.5	17.2	18.9

Source: Euromonitor

\$ Million	2005	2006	2007	2008	2009	2010
Dog and Cat Food	225	250	278	307	336	366
Other Pet Food	0.4	0.4	0.5	0.5	0.5	0.6
Pet Care Products	340	380	423	466	505	541

Source: Euromonitor

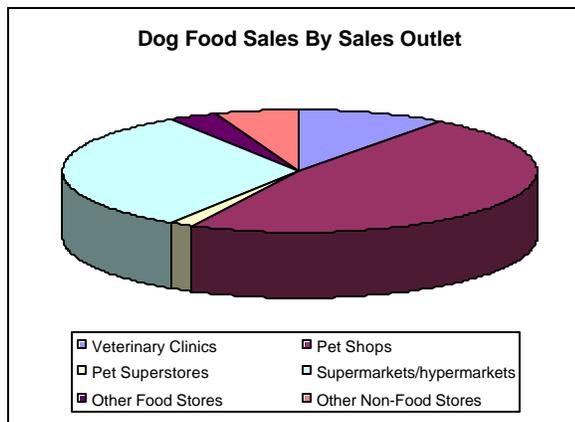
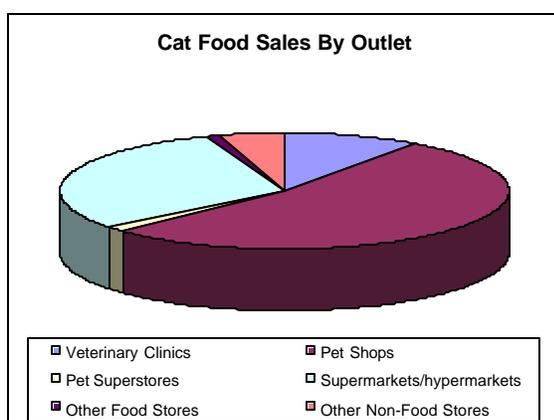
pet food sold in the major Chinese markets. Wet food, semi-wet, and treats account for 25, 14, and one percent, respectively, of total sales.

Dog Food

Dog food is the most attractive growth segment for pet food retailers because of the rapid growth in the number of dogs being fed commercial food, tripling in the past five years. As noted in Table 2, urban dog ownership is highest in Beijing and Shanghai. As described above, dog owners are considered to have a generally higher income than cat owners and the use of commercial feed greatly exceeds the trend for cats. Due to the urban environment, the most popular dogs are medium to small breeds.

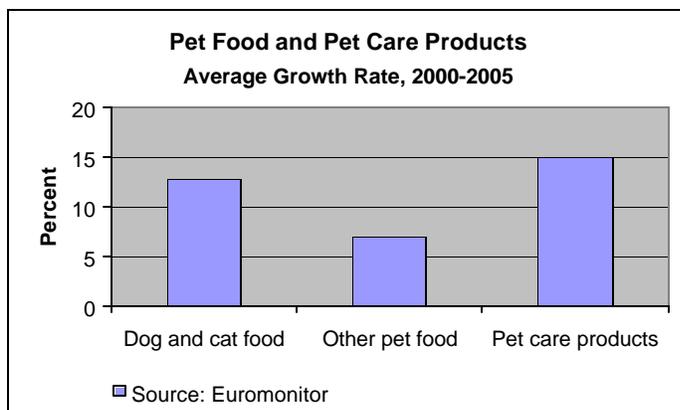
While elderly people and people in the middle income bracket tend to keep medium and small dogs, upper income people keep all breeds of dogs, even large dogs. The higher levels of income suggest larger living quarters and the ability to meet the larger nutritional requirements of these animals. Affluent people are also more likely to purchase purebred dogs. These animals usually get the best imported pet food and additional pet treats and grooming. Overall, high consumer incomes, education, and brand recognition have made dogs the most likely to get commercial pet food and as a result, the hottest pet food market. Growth in dog food sales is expected to exceed ten percent per year for the medium term.

Two companies currently dominate the dog food market. Effem Foods Beijing, a subsidiary of Mars Inc., is the dominant company in the low and medium categories with almost 50 percent market share. Effem produces the brand “Pedigree” in China and it is the dominant commercial dog food. *Pedigree* captures the low and mid-price range with both dry and wet food with many different types, sizes, and package styles. Effem also has several other well-known brands. “Royal Canine” is the largest imported brand in terms of sales, the second largest in terms of overall sales, and the leader of the premium category. Royal Canine possesses approximately 15 percent of the market.



Source: Euromonitor

(Though Royal Canine is also a subsidiary of Mars, it's China operation is currently an independent brand.) Companies with single-digit market share include Nestle, Hills, Purina, and the Chinese companies Zhangjiagang Lianfeng, Shenzhen Libangda, Shandong Weifang Pinghe, Chengdu Care, and Yantai China. Currently, Effem is the only foreign company with significant domestic production capacity, while the other companies import their products.



The Chinese companies currently have a very small regional presence in the lower end of the market, but are growing fast. These companies' quality and distribution is improving very rapidly and they will be important competitors in the medium term.

Currently, Effem and the Chinese companies have a significant price advantage over imported products. For that reason, imported products mainly target the upper-middle and premium pet food categories. As a result, all the major international

brand names and many smaller imported brands are struggling to build a brand presence in the premium market and the competition to create consumer loyalty is fierce. (Additional information about the opportunities and challenges of the premium sector for both dog and cat food are included in the Market Opportunities section below.)

In addition to pet food, these international companies are importing a wide variety of supplementary and specialty products. The key products in this category are specialty diet formulas and pet treats.

Cat Food

While cats have been a more traditional pet for urban Chinese and there are significantly more of them, use of commercial cat food has progressed slower than with dogs. Dogs are perceived by many Chinese to be better companion animals when there is the choice between the two. Upper income Chinese would also choose a dog over a cat when considering the prestige of pet ownership. Nevertheless, the cat population is growing and the use of commercial feed is also increasing.

Effem Beijing also holds approximately 50 percent market share in the commercial cat food market, based on the strength of the internationally known brand "Whiskas". Again, "Royal Canine" comes in second in total sales in the cat food market and is the largest imported cat food with a market share of about ten percent. The other foreign and domestic players also vie for the cat food market, with no brand enjoying over single digit market share. Cat food shows the same stratification, as Effem and the Chinese companies focus on the middle and lower end market and imported brands dominate the upper and premium categories.

MT	2000	2001	2002	2003	2004	2005
Dog and cat food	39,000	44,000	49,700	56,000	63,000	70,000
Other pet food	35	40	41	44	48	52

Sources: Euromonitor and Pet Food Institute

Premium Segment Market Opportunities

Currently, the best prospects for imported products reside in the upper and premium product segments. The three pillars for success in these markets are efficient distribution, strong brand management, and consumer education.

Distribution networks remain problematic in many parts of China and the distribution of specialty products, such as pet food, requires efficient supply management. Without a constant stock of these products, veterinarians and other key educators are less likely to know the brand and its qualities and less likely to recommend it. As mentioned above, there are many new pet owners and people relying on the advice of professionals connected to the main sales outlets (pet stores). Therefore, it is critical that a premium brand have a strong presence in the locations where consumers get initial exposure and education about new products.



Veterinary Advice at Pet Food Institute Booth, Pet Fair Asia 2006

The second pillar of a strong premium brand in China is brand management. Premium brand management in China is not unlike this segment in developed country markets. Potential customers in the upper income bracket in China are very brand conscious. A top brand promoted in pet magazines and recognized as excellent in terms of nutrition is as important as price.

The last pillar is consumer education. Many people in this category are new pet owners or people buying larger or pedigree animals, so few have really long term experience caring for domestic animals. For example, very few adult Chinese had pets as children and have little knowledge of animal nutrition, care, or commercial pet food. Thus, the role of the veterinarian and local pet store sales person is vital in educating consumers about the quality of new products. Creating a strong sales team and educated retail sales force is critical in product promotion.

Below are some additional opportunities and challenges for U.S. exporters targeting the premium pet food segment:

Opportunities	Challenges
Educated pet owners are aware of the health benefits of feeding manufactured pet food.	Less than 25 percent of total pet owners consistently feed their pets manufactured feed.
U.S. pet food enjoys a very good reputation among the educated, high-end income population.	Lack of consistent distribution hinders U.S. product image.
Domestic manufacturers appeal only to the low price segment.	Domestic manufacturers produce lower quality products, but the quality is improving.

New to market exporters benefit from education campaigns and investments existing foreign companies have already made in the market. Imported pet food enjoys a very positive image.	Multinationals have established brand names and distribution systems in place in all price segments. Competition is already very high.
As upper income pet owner knowledge increases and the degree of sophistication improves, pet owners are more likely to opt for premium products.	The premium market is still developing. Lucrative commissions charged by high-end distribution channels offset profits.
Efficient logistics and distribution channels outside the major cities can provide a significant competitive advantage.	Few service providers exist for pet food. Establishing a functioning distribution system is difficult.
Gray market and non-licensed operators have built brand recognition for imported brands.	Gray market and non-licensed operators may counterfeit merchandise, highjack non-registered trademarks, or act against long-term brand strategy.
Consumers demand small package sizes.	Demand for loose/bulk sales pose challenge to brand awareness and marketing.
Chinese are generally brand loyal.	Many new pet owners need to be educated. The marketing costs are high relative to sales during the market development phase.

China currently imports about 20,000 MT of pet food from Brazil, Australia, France, and the United States. Imports are mainly comprised of the established international brands being sourced from various global production facilities, such as Royal Canine products from Brazil. However, there are also small exporters from a number of countries that export specialty and lesser-known, branded pet foods. A potential problem is the distribution of certain brands in China by independent importers, rather than the parent company. These imports often come through gray market channels and are sold in China without the knowledge or permission of the parent company. More on this topic is provided in the Intellectual Property Rights section.

Regulatory Environment

During the course of 2006, the regulatory control over the import of pet food into China has become more stringent. Specifically, the registration of new types of pet food is difficult and time consuming. U.S. exporters are recommended to find and work with a reputable and trustworthy import agent with experience in this area to complete the process.

Before pet food can be exported to China, U.S. exporters/manufacturers or agents acting on their behalf must obtain a certificate of registration issued by China's Ministry of Agriculture. Imported pet food is regulated under the People's Republic of China's *Import Regulation and Standards Imported Feed and Feed Additive Registration Regulation*. This regulation is designed to protect animal safety and strengthen supervision of imported feed and feed additives. Foreign feed and feed additive processed products must be registered prior to being sold in the People's Republic of China. The registration process is cumbersome, time consuming, and more expensive than most other countries. The preparatory documents are exhaustive and proper formatting for submission to the Ministry of Agriculture is important.

For detailed information on the registration, examination, and approval process, please see GAIN report CH6080.

In addition to the product registration, any plant that is considering exporting pet food needs to request certification by the China Administration for Quality, Safety, Inspection, and Quarantine (AQSIQ). China requires that this export certification be completed and held by USDA's Animal and Plant Health Inspection Services (APHIS). Individual plants may require Chinese inspection of the production facility. Prior to export, APHIS would also certify that shipments meet certain Chinese requirements and do not pose animal health risks. Due to the continuing Chinese ban on U.S. exports of products containing bovine or ovine material, China requires a Polymerase Chain Reaction (PCR) test to confirm the absence of such material.

One additional recent change to the regulatory environment is the increase in random testing of pet food products taken from retail locations. This is done by either the Ministry of Agriculture (MOA) or the local/provincial government in coordination with MOA. There have been complaints by the trade that this testing is too strict in demanding the product components be within tight limits tested during registration without consideration of the significance of the difference or if it has a nutritional impact. An additional difficulty is with the number of gray market or counterfeit products in China. While the testing is a heavy burden for legally importing companies, the illegal producers or sellers are not being held to the same standard of fines or identification because there are no efforts to track down these counterfeit producers.

Reference Information Specifically Related to Pet Food Registration:

Feed and Feed Additives Registration Update (GAIN report CH6080)
Imported Feed and Feed Additive Registration Regulation. (GAIN report CH1057)
GB/T 10648: Labeling requirements (GAIN report CH2040)

Additional Reference Regulations and Announcements:

MOA Announcement 517 "Additional Chinese Product Registration Requirements." (GAIN report CH6081)
Hygienic Standards for Animal Feed (GAIN report CH6084)
GB/T 18832- Allowable Error in Judging Quality Testing Results in Feeds" (GAIN CH6101)
MOA Announcement 517 "Additional Chinese Product Registration Requirements." (GAIN report CH6081)
GB/T 10647: General Terminology of the Feed Industry

Intellectual Property Rights (IPR)

As with any premium product, branding and product placement are keys to success and any effective marketing campaign promoting a brand in China will lead to counterfeiters capitalizing on brand recognition. Where branding is the key to product differentiation, trademark and logo registration is critical. Where trade secrets are key to product differentiation, U.S. companies are advised not to share these secrets with Chinese partners. In addition to registering trademarks, logos and certification marks, foreign companies seeking to distribute their products in China should register their marks and/or logos with the Trademark Office; any Chinese language translations and appropriate Internet domains should also be registered. Foreign parties must use the services of approved Chinese agents when submitting trademark applications.

Once a trademark or logo is registered and you discover that your trademark is being infringed, act immediately to protect and enforce your rights. Investigations, raids, seizures

as well as civil litigation and criminal prosecutions are some of the tools available. Which tool is most appropriate depends on whether the trademark is registered or otherwise eligible for protection in China, where the harm occurs, and the infringer. Protecting your intellectual property rights normally requires professional advice.

FAS does not provide legal advice, but has established an IPR office that can provide guidance and suggest best practices on registration and enforcement, as well as a list of IPR attorneys. The Agricultural Trade Offices will be your first line of contact to the FAS IPR Office.

Key Contacts and Further Information

For trade policy and analytical information, please contact:

Agricultural Affairs Office (AAO) Beijing: Agbeijing@usda.gov (86-10) 6532-1932

For further regional information and marketing assistance, please contact the appropriate Agricultural Trade Office (ATO):

ATO Beijing: ATOBeijing@usda.gov (86-10) 8529-9962

ATO Shanghai: ATOShanghai@usda.gov (86-21) 6279-8336

ATO Guangzhou: ATOGuangzhou@usda.gov (86-20) 8667-0703

In addition to the above mentioned technical reports, FAS has prepared several reports to help U.S. exporters deal with business practices and other practical topics. These can also be referenced from the **Foreign Agricultural Service's** website: <http://www.fas.usda.gov/>

ATOs work closely with U.S. pet food industry and its industry representative overseas, the Pet Food Institute. Its contact information in China is:

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Useful websites and articles

Pet Food Institute
www.petfoodinstitute.org

China National Kennel Club
<http://www.cnkc.org/en/index.php>

U.S Commercial Service China's Business Information Center
<http://www.export.gov/china>

Animal Plant and Health Inspection Services (APHIS)
<http://www.aphis.usda.gov/>

Changing Attitudes to Pet Ownership Drive Pet Food Sales
<http://euromonitor.com/>

Pet Fair Asia Professional (September 19-20, Shanghai)
<http://www.petfairasia.com>

China International Pet Show (October 11-14, Beijing)
<http://www.cipscom.com/>