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Xi'an: Gateway to the West

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Report Highlights: Renowned for its many historical landmarks and heavy industry, Xi'an is evolving into a business gateway to the vast western regions of China. The economy of China's West is rapidly gaining on that of the East, where land, labor and other costs have skyrocketed in recent years. As a result, Xi'an has emerged as one of the main focal points of the Great Western Development Project launched by the Chinese government. While the market share of foreign-invested businesses is limited, increased investment, improved infrastructure, and preferential development policies have all combined to support growth. The increasingly affluent population, combined with millions of domestic and international visitors each year, has created opportunities for imported food and agricultural products.

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Xi'an: Past and Present

At a time when Beijing was only a remote trading outpost and Shanghai a tiny fishing village, Xi'an was the world's first city to have a population of more than one million. It was also the first international commercial center in China, serving as a starting point for the Silk Road, and renowned cultural and political seat of power for 13 Chinese dynasties and 73 emperors.

Though long removed from its past glory, today's Xi'an is the capital of Shaanxi Province and the largest city in northwestern China. Modern Xi'an is home to 41 universities and colleges, 3,300 research development and technological institutions, and more than 50 state-level laboratories and testing centers.



Xi'an is recognized as perhaps the most important birthplace of classical Chinese civilization and culture, which in more modern times drives a booming tourism industry, welcoming more than 70 million domestic and an additional 1 million plus international visitors each year. Qin Shi Huang, the First Emperor of China, who united 7 kingdoms and formed China in 221 B.C., made Xi'an the capital of his new empire. Today, the city is home to the world-famous army of underground Terracotta Warriors, who guard the First Emperor's tomb, and a host of other must-see historical and World Heritage cultural sites.

Xi'an is a key outpost in China's West: While the region as a whole has been growing slowly, Xi'an is a highly developed metropolis with a population of 7.4 million. Private vehicle ownership reached 50,262 cars in 2006, representing a 5% increase over 2005. China's Central Government considers Xi'an, along with the Chongqing Municipality, as the main driver of its Great Western Development Project (GWDP) initiative.

Xi'an Economy at a Glance	
GDP	RMB127.0 billion
Fixed-Asset Investment	RMB83.5 billion
Value-Added Industrial Output	RMB42.0 billion
Total Retail Sales of Consumer Goods	RMB66.7 billion
Consumer Price Index	0.3%
Government Revenue	RMB8.4 billion
Population	RMB7.4 million
Urban Disposable Per Capita Income	RMB 9,628
Rural Net Per Capita Income	RMB 3,460
Total Trade	US\$ 3.9 billion
Exports	US\$ 2.6 billion
Of which FIE Exports	US\$ 195 million
Imports	US\$ 1.3 billion

Source: Xi'an Municipal Bureau of Foreign Trade and Economic

Industrial Hub of the West

Shaanxi province is rich in coal, iron, and other energy and mineral resources that are the backbone of China's industrial development. Xi'an is the urban center of China's most energy-rich region: explored natural gas reserves in three western provinces, Shaanxi, Sichuan, and Xinjiang, make up 61% of the nation's total; overall estimated reserves in the region account for more than 84%.

Petrochemicals industry is both the largest employer and the number one producer in Shaanxi, supplying 15-20% of total industrial value added output year on year for the province. Other major industries include electricity, heat, large equipment manufacturing (including aircraft), telecommunications, textiles, and electronics manufacturing. Secondary industries include a bustling trade in industrial chemicals, pharmaceuticals, building materials, metallurgy, food products, and, of course the most famous, tourism.



The world's two aviation giants, Boeing and Airbus, have both been building ties with a number of local manufacturers amid expectations that Xi'an will emerge as a major aircraft manufacturing center in China, which currently represents the world's fastest-growing aviation market. Other major manufacturers include General Electric, Coca-Cola, Datang Telecom, Sea Star, Ginwa, Standard Sewing Machine and Lijun Pharmaceuticals. One of the oldest and most successful foreign investment projects is the Xi'an-Janssen Pharmaceutical plant, a subsidiary of the US giant Johnson & Johnson. The US\$ 190 million plant is now the largest pharmaceutical joint venture in China.

The province is rich in agricultural land and resources: Agricultural export values accounted for 10.4% of overall exports values leaving Shaanxi in 2006. Fruit exports make up more than 80% of the province's agricultural exports, reaching a reported US\$ 308 million in 2006 alone. Apples and stone fruit make up most of Shaanxi's horticultural exports.

In October 2006, the Ministry of Commerce selected Xi'an as one of a group of cities designated as China's first outsourcing "bases", with economic and policy incentives to encourage this highly lucrative work. Furthermore, in early 2007, Xi'an was selected as the location of a major cargo airplane development and manufacturing project. Along with Airbus and Boeing, Rolls Royce has also been sourcing parts and components from subcontracted manufacturing facilities in Xi'an. An annual China Western Region Foreign Trade and Investment Fair is held each year in the city.



By Car, Plane or Train: Xi'an Infrastructure

Xi'an's Xianyang airport is the largest airport in western China and has been in operation since 1991. For the last several years the airport has functioned at maximum capacity to accommodate a growing flow of tourists and business travelers. The airport is scheduled for a nearly US\$ 800 million expansion, with a new runway and terminal slated to open by 2011.

The improved airport will be able to handle more than 16 million passengers annually, an increase of 6 million above present capacity. Flights currently link Xi'an to all of China's major cities as well as international routes to Hong Kong, Japan, Singapore, Korea, and Europe.

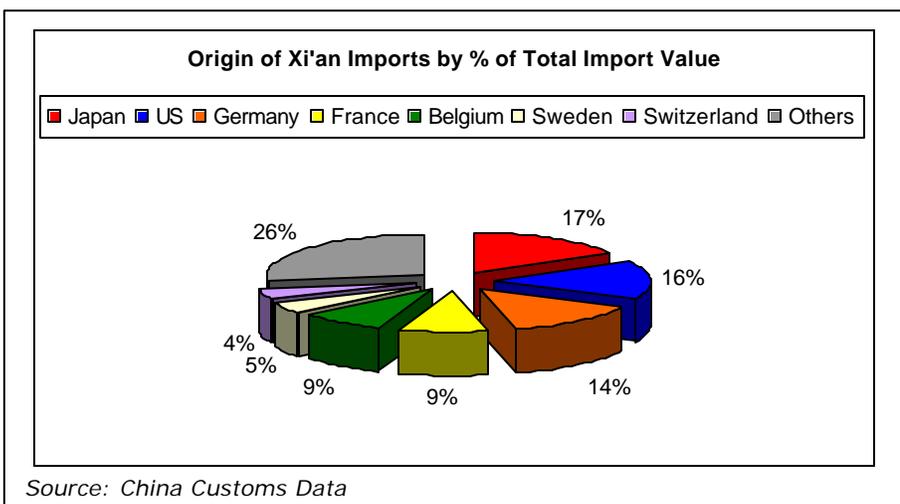
Xi'an serves as a land transportation hub for Shaanxi province and western China, with overland passenger bus and train links to most major cities, including direct deluxe service to Beijing and Shanghai. The city is also a freight transportation hub for cargo trucks and China's extensive railway network. Xi'an handles 36 million tons of rail freight annually, which ranks it as one of the largest provincial rail hubs. There are a total of 385 km of expressways and highways, reaching most areas of the province. The city, however, is roughly 700 miles from China's nearest coastal cities, with average overland transportation times to Beijing or Shanghai ranging between 12-13 hours depending upon traffic.

Retail Work in Progress

Xi'an is one of western China's key retail centers, and home to some of the first pioneering international Joint Venture (JV) retailers in the region. Both domestic and international tourists make a substantial contribution to demand and market forces/trends. As an interior city, Xi'an in general is a price-sensitive market. However, major local retailers reveal consumers are receptive to high quality, high value food and agricultural product imports, if given the opportunity to taste, and educated how to use them prior to purchase. Seeing is believing, which means retail promotion and product demonstrations are highly effective and direct ways to reach and educate consumers in the Xi'an market.

Due to limited exposure to imports, the market for imported food is currently limited: an assortment of snack foods, breakfast cereals, food ingredients, sauces and beverages are basically what is available at this point. Retail sales vary widely, depending on store location. For example, stores near the Bell Tower area are usually considered to be on premium turf, with brisk customer flow and good profits. On the one hand, given the fact Xi'an is the academic and IT center of the West, it is not surprising students, young academics, expatriates and white-collar workers are core imported food consumers, similar to the East coast of China. On the other hand, Xi'an has lower disposable incomes and dietary habits that are very different from Eastern coastal regions, and therefore the retail sector in Xi'an still has a lot of room for growth and development.

During major holidays like Spring Festival, Mid-Autumn Festival, or Valentine's Day, imported festive gifts like boxed chocolates, nuts, wines and liquors are consumer favorites. Retailers usually seek supply lines of imported products through distributors in Beijing, Shanghai or Guangzhou via air or rail. Local distribution channels and markets



are inconsistent and supplies unstable, with counterfeit or fake beverage and liquor products common. U.S. products, compared to Asian and European counterparts, are at a disadvantage due to higher logistical costs and currently enjoy limited market share.

It appears, however, change is on the way with domestic and international operators rushing into the area to get a piece of the action. Over the last year alone construction of more than 23 new retail and/or department stores was reportedly underway in Xi'an. Among these, retail outlets such as Century-Ginwa, Parkson, Kaiyuan, and Metro are looking to Xi'an to expand their chain operations in Shaanxi.

Xi'an Retail Outlets

Type	Name	Ownership	Outlets
Hypermarkets	Carrefour	French JV	2
	Metro	German JV	1
Supermarkets	Wal-Mart	US	Planning
	Trust-Mart	Taiwan	2
	Century-Ginwa	Local	1
	Kai Yuan	Local	1
	Parkson Retail	Hong Kong JV	1
	Lotus	Thailand	1

Xi'an has the strongest purchasing power in Shaanxi Province, which makes it an attractive prospect for foreign businesses. All of the international retailers in Shaanxi have opened outlets in Xi'an but none in any of the other 10 major cities in the province. Total retail sales of international

retail outlets in the city amounted to RMB797 million for the first half of 2006, more than five times the increase in Xi'an's total retail sales. Although these international retailers only enjoy a small market share, they continue to exhibit strong growth momentum: While these international retail outlets only contributed to 2.1% to total retail sales in Xi'an in the first half of 2006, they recorded a 71% increase in the number of outlets as well as a 85.4% surge in retail sales. Perhaps most importantly, the arrival of well-known international retailers such as Metro, Lotus and Carrefour continued to promote innovation, competition and as a result transform many traditional operations in Xi'an.

Tourism and HRI Sector Growth



In comparison to retail, Xi'an's HRI (Hotel, Restaurant and Institutional) sector is much more developed, in large part due to the thriving tourism industry. A large number of major international hotel brands have arrived to serve this substantial market. Hyatt Regency, Shangri-La, Howard Johnson, Sheraton, Mercure and ANA Hotels all have a presence here; Kempinski has plans to open a hotel in Xi'an next year. Official figures indicate that around 70 million domestic Chinese visitors and over 1 million international tourists traveled to Shaanxi province

last year. International tourist visits are expected to increase at a rate of over 15% annually.

With the increasing number of world-class hotels and well-heeled tourists, the HRI sector is the largest client base for imported food and food ingredients. Most local hotels have relatively high imported food budgets in order to cater to the tastes of overseas entrepreneurs, investors and tourists who frequent the city. However, due to limited knowledge of imported food, some food service operators tend to cut costs by substituting



imported ingredients with local products. One of the primary reasons is that clients and customers often are not aware of the health and safety benefits of high quality and high value imports, and price becomes a major factor. Most imported products are confined to breakfast items and food ingredients catering to the tourist trade. Domestic tourists and locals still express a clear preference for Shaanxi foods.

Five- and four-star hotels generate the greatest demand for imported foods, with bottled water, cheese, wine, and seafood topping their shopping list. As with retail, the majority of imported food and beverage consumers are still predominantly international, and not local. Yet local business people favor imported wine, other alcoholic beverages and food for working lunches and business banquets. A vibrant bar-culture is emerging: Like San Li Tun in Beijing or Xin Tian Di in Shanghai, De Fu Xiang is the bar street in Xi'an. Although it is less than 200 meters long, the street is full of bustling bars, coffee shops and clubs, making it Xi'an's premiere nightlife hotspot.

Entry into the Xi'an market requires familiarity with the particular tastes and preferences of the city's residents. Stand-alone restaurants are very popular, especially for local snacks and specialties. Xi'an cuisine usually features noodles, bread, and heavy, starchy food items with complex, savory flavors. A high Muslim population—with Central Asian cultural influence—means that lamb, beef and chicken dishes are extremely popular, as are dishes based around ancient stories from local folklore. Western-style dining is still in initial stages of development, and restaurants are very few. Although locally produced food is available at substantially lower prices, proper promotion of imported goods and foods, with strong emphasis on quality and safety, can help overcome price sensitivity in the longer term.

Food Processing

Although Xi'an is a major processing industrial base and the largest trade hub in central and western China, at this stage activity is focused primarily on engineering and basic processing of locally grown products. Shaanxi dried fruits, nuts and related products are popular all over China, and the province is one of the primary producers of these products for the domestic market. Other key agricultural products of the region include cotton, rice, corn, millet, wheat, sweet potatoes, beef cattle and sheep.

Shaanxi province has supported the establishment of a large apple production area, and many of its products meet China's "green" and/or "organic" product standards with some even meeting international "organic" standards as well. The apple and apple juice industry has proven to be both a significant and a highly profitable export trade for the region. Juice export values in 2006 reached US\$ 281 million, accounting for nearly 75% of Shaanxi's agricultural exports—the province also exported US\$ 12.7 million in fresh apples.

What's In a Trademark?

While Xi'an is not immune to the weak IPR protection and enforcement that plagues much of China as a whole, significant steps have been taken to encourage strengthening of legal systems and more transparency at the local level. By the end of 2006, 13 agricultural product trademarks and/or logos originating from Shaanxi had been officially registered. The majority of products registered had a strong geographical origin component, for example: Yanchuan Dates, Lintong Pomegranates, and Shaanxi Apples (all named for the location or region where they are produced). Shaanxi Apples are currently registered not only in China but also in more than 25 European and other countries.

At this juncture, there is not a large volume of imported food product processing in the province—due in part to the region's dietary habits, lack of awareness of potential food ingredients, and given that consumption is still relatively low on the value chain.

Go West, Investor

The Chinese government launched The Great Western Development Project (GWDP) in 1999 to narrow the economic gap between the Western region and the country's coastal East. Key goals include attracting foreign direct investment (FDI) and developing infrastructure across the region. Preferential policies, coupled with the abundant energy supply, cheap land and labor all present attractive opportunities for overseas and domestic investors, but many investors are still employing a wait-and-see approach toward the city's and region's development. The prospect of rapid economic expansion is improving, however, with more than 80 Fortune 500 companies having established a presence in Xi'an.

Shaanxi has benefited from sustained high levels of investment and government support in the form of subsidies for modernization of infrastructure, industrial technology, etc. The telecommunications and electronics sectors represent relatively successful attempts on the part of the provincial government to diversify and improve the technological sophistication of the province's manufacturing base—while these initiatives have produced only around 5% of provincial GDP during each of the past few years and are low-value-added assembly operations; they have extremely strong growth prospects.

The Xi'an Municipal Government has also stepped up to the plate in an effort to encourage the development of commerce and trade. The "Imperial City Restoration Project", a city plan aimed at turning Xi'an into the "commercial center of western China" has been targeted for the next several decades. With this in mind, Xi'an's Commercial and Trade Bureau has already developed a plan to improve commercial networks over the next fifteen years.

Market Entry Tips

The imported food market in Xi'an is not yet fully developed. Some of the industry players offer the following tips for entering the market:

1. **Consumer Awareness:** Many products fail because distributors and consumers are unfamiliar with the products, and are not sure how to handle or use them.
2. **Product Knowledge:** In-store product demos and marketing promotions in Chinese can be very successful advertising methods. Promotions that focus on adapting US food ingredients to Chinese cuisine are suggested.
3. **Price and Food Safety:** Xi'an is still a price-sensitive market and imported items must compete with low-priced domestic products. Establishing a brand or item as "premium quality" is a must for selling in a highly competitive environment, and American products are often appreciated for meeting stringent safety standards.
4. **Research:** Take time to investigate the market and find a good distributor. Successful ventures require experienced distributors who know the local market.
5. **Test the Waters:** Proceed with caution before attempting large-scale supply to the market. Be prepared to offer limited quantities and build your network slowly. If a product is new to the China market, it may be better to introduce it to already established markets where unfamiliar foods are easily adopted, like Beijing or Shanghai.
6. **Holidays:** Demand for imported goods is increasing, particularly during holiday periods, when such goods are often given as presents, and are associated with upward mobility.
7. **Follow the Leader:** Build relationships with successful exporters to China, and learn from their examples.

Best potential products from the US at present: Boxed cereals & breakfast products; Chocolate & sweets; Condiments; Dairy products; Nuts & snack foods; Wine & liquors.

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Official Xi'an Website

<http://www.xa.gov.cn/>

China Western Region Foreign Trade and Investment Fair

<http://inwest.ccpit.org/>