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## China, Peoples Republic of

### Retail Food Sector

### 2007 North China Retail Update

### 2007

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**Report Highlights:**

North China's retail food sector continued to be characterized by the highly explosive growth of the last few years as multinationals retailers aggressively pursued new opportunities in China's Emerging City Markets, and domestic retailers sought to protect market share through expansion. Rising incomes, food safety concerns, and improving standards of living all contributed to the rise in high quality food imports use by consumers. In addition, distribution and logistical improvements in Beijing and many parts of North China contributed to improved access for imported food products and opportunities for suppliers to penetrate this potentially lucrative retail market.

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### North Retail Market Overview

North China's retail food sector continued to experience highly explosive growth over the past 5 years, evolving from a highly fragmented industry composed of mostly small, independent retail outlets, and transformed into a retail sector characterized by hypermarkets, supermarkets at the high end, and convenience as well as discount stores at the low end. As multinational retailers aggressively seek new growth opportunities in China's Emerging City Markets (ECM) (*please see CH7403*) and local operators expand to protect market share, the transformation continues. The growth is largely due to the China's geographic and economic structural changes along with the momentum of strong public and private sector investment and development. "There has been a trend in recent years of the most dynamic economic growth in China shifting away from the south and toward the north of the country", according to the Development Research Centre of the State Council. Retail deregulation, which came late in 2004 as a requirement for China's accession to the WTO, allows international companies to hold 100% equity in Chinese firms. This in turn has triggered the recent acceleration in China's retail growth and expansion. The heightened pace of new store openings has been so rapid that some local governments are now considering new regulations aimed at actually impeding or restricting growth. For example, in early 2007, Beijing's Municipal Government announced plans to adopt a policy that would prohibit construction of new hypermarkets or supermarkets with total areas in excess of 6,000 square meters within the 3<sup>rd</sup> Ring Road of Beijing.

Major factors limiting North China's retail growth are income, price and distribution. The vast rural population in North China still largely remains beyond the reach of modern retail due to consumer income and price constraints. Nevertheless, as economic development continues to spread into rural areas, good potential for long-term market penetration and sales growth in rural consumer groups is apparent. In the short term, however, many populations are still outside the scope of most large retailers due to income disparity between rural and urban consumers. The lack of advanced infrastructure, logistical and management systems pose serious impediments to getting goods to market since distribution is often underdeveloped and very uneven. While improving rapidly, inadequate infrastructure in many parts of North China prevents retailers from opening or acquiring new stores at a pace they would like, due to the difficulties associated with developing effective, cost efficient distribution systems. Concomitantly, the wholesale sector which evolved in large part to meet the demands of China's earlier retail expansion continues to lag behind the retail sector given a variety of structural issues in China, and North China.

### North China Retailers

Top multinational retailers in the north include retail giants such as Wal-mart, Carrefour, Metro and Tesco. Carrefour, the largest of the four major multinationals operating in China, continues to dominate the North China retail market. Leading local retailers such as Beijing Hualian, Beijing Wu-mart, Beijing Jingkeolong and Dalian Dashang have demonstrated an ability to adapt to the market and modern retail practices. Thus, these domestic retailers continue to be key and often formidable players in the current retail market. In addition, domestic regional and national retailers continue to reap the benefits of their unique local and cultural knowledge of the market as well as government support.

Hypermarkets in Beijing have begun to cater to car owners, offering larger shopping carts and more parking spaces to accommodate the ever increasing number of shoppers arriving at retail stores in automobiles. However, this trend has yet to catch on in hypermarkets in other northern cities. A common strategy employed by hypermarkets, as well as by other retail formats and venues, is to adjust the quantities and variety of imported food products based on neighborhood average income and consumer preference. Sam's Club sells 3 times as much imported food as the Wal-mart Super-Centre in Beijing, although the ratio of imports is only 3-5% of sales.

Supermarkets have been the preferred format for multi-national and domestic operators because these formats provide a good balance of the floor space required for expansion, and product mix to attract shoppers yet remain profitable. Most supermarkets in Beijing are located within walking distance of neighborhood consumers, thus shoppers tend to visit stores more frequently but purchase less each time. Beijing had more than 1,377 supermarkets operating with total retail sales of USD18 billion Jan-May, 2007.

Discount stores have proved to be a popular format to attract low income consumers. Carrefour-owned discount store DIA currently has 115 outlets throughout Beijing. The stores target consumers with annual household incomes of USD 6,000-10,000. Very limited numbers of imported food items are sold in these formats at present. However, according to one DIA Fresh Produce Purchasing Manager interviewed, DIA normally purchases imported fruit for sale during major holiday periods.

While convenience stores are expanding in urban centers and appeal mostly to young and more discerning consumers. These stores can be characterized as clean, well managed and heavily automated with real time inventory systems and offer single servings, etc. In many places, these stores have rapidly replaced the traditional family-owned stores or kiosks that sell snacks and drinks, but stock very few imported products. However, there are rumblings at play that indicate at least some convenience store chains are re-thinking their strategies to accommodate Beijing's burgeoning car owner class, much in the same way hypermarkets have attempted to attract this growing segment. In addition, 24-hour service is somewhat less of an advantage in the colder North. Consequently, some local convenience store chains, particularly in the northeast operate on fixed hour schedules to accommodate local market preferences.

Table 1: Major Hypermarkets/Supermarkets in Beijing

Retailer	Ownership	2006 Total Sales (Million USD)	Percentage of Sales Increase Over 2005	No. of Outlets (As of Oct. 2007)
Beijing Hualian Group	China	108	27	100
Beijing Wu-mart	China	670.6	37.4	659
Beijing Jingkelong	China	596	9.9	180
Carrefour	France JV	3,501 (nationwide)	21	103 (nationwide)
Wal-mart	USA	1,980 (nationwide)	30	86 (nationwide)
Metro	Germany JV	1,100 (nationwide)	16.7	34 (nationwide)

Source: Business Monitor, CCFA/ATO Beijing

### North Region Update

In Beijing proper, the most rapid development is taking place in the fast expanding suburbs, which also experienced a surge in car ownership. Unlike Shanghai or Guangzhou, Beijing is not at the center of a broad economic development web, with Tianjin the only nearby urban area worthy of mention. However, the Northern border region is home to some of China's most dynamic coastal Emerging City Markets, including the cities of Dalian, Qingdao and major industrial powerhouses of Shenyang and Harbin. Beijing is one of China's largest and most affluent consumer markets accounting for nearly 5% of national retail sales. In 2006, growth in retail sales increased by 12.6%, although still below the record high 14.5% in 2004. Retail demand remains steady, especially in the food and beverage market segments, and multi-national retailers such as Carrefour, Wal-mart and Metro, as well as most domestic retail operators enjoyed significant expansion and substantial growth during 2006-2007.

Beijing based Jingkelong Company Limited opened 19 retail outlets in 2006 with 180 outlets in total by October 2007 which includes hypermarkets, supermarkets and convenience stores. The company accelerated its greater Beijing area coverage by consolidating its regional focus in Chaoyang District in Beijing. Surprisingly, known as the largest State-run retailers in the city, Jingkelong established imported food sections in some of its stores targeted at consumers in middle-income neighborhoods, even though international invested retailers remain the major retail suppliers of imported food. In recent years, Jenny Lou's, a local imported food and beverage specialty retailer developed a good business serving the needs of expatriates, and overseas Chinese in and around diplomatic compounds and embassies. However, increasingly shoppers at Jenny Lou's, and several other specialty retailers that target imported food product consumers, are up-market Chinese consumers who are wealthy or lived abroad or both.

Shopping centers continue to mushroom and Beijing is now home to many of the country's largest and most famous shopping malls, such as the Lufthansa Shopping Center, The Place, Shin Kong Plaza, etc. Most of these have high-end supermarkets with a large percentage of imported food and beverage items. Beijing retailers hold US products in high regard for their quality and increasingly safety, although European, Korean and other suppliers are also rising in popularity. Shelf surveys reveal special sections devoted to imported beer, fruit juice, wine, etc. Dairy cases are expanding, often displaying imported as well as local cheeses. Substantial displays of imported breakfast cereals, cookies and beverages are also not uncommon. According to some major importers-suppliers in Beijing, imported food and beverage product sales are expected to rise at the retail (supermarket) level as the cost of domestic food products increases, as in 2007, and the price difference between domestic and imported products narrows. This is being driven by a rise in domestic prices as well as the positive effect of the Dollar-Yuan exchange rates relative to products from the U.S. Based on interviews with several store managers of major supermarkets in Beijing, it appears that individual store sales in Beijing are already a vibrant market for up-market or high-income consumer purchases. Post forecasts retailers are likely to receive a significant boost from the effects of domestic as well as international tourism related to the 2008 Olympic Games being held here in August of next year, and the continuing development of retail infrastructure and consolidation in Beijing.

In Tianjin, several international retailers like Carrefour, Wal-mart and Metro have good penetration in a mostly local retail market there. In addition, imported food products are not widespread and are even less common in smaller retail formats. The large and modern port area, including Tanggu and Tianjin Economic Development Area (TEDA), has proven to be a better market for imported goods and food products due to the large number of expatriates living there. However, Tianjin realized a significant 24 percent increase in the import of U.S. food products during the period 2004-2006. In August 2007, the largest organic supermarket in China was established in the Binhai District of Tianjin with a retail area greater than 400 square meters, and a total investment of more than a half million US dollars.

Shandong, a coastal province south of Beijing, is home to a number of growing industrial cities characterized by rising consumer incomes. As one of the largest consumer markets in China, Shandong retail sales of consumer goods increased 16.3% to USD 93.7 billion in 2006, which accounted for 9.3% of the national total. Retail sales in the urban markets reached USD 70 billion compared to 23.7 billion in the rural market. Major commercial centers are located in Jinan, Qingdao, Yantai, and Weihai. Companies from nearby Japan and Korea have invested heavily in the development of the province's infrastructure, including the cold chain creating ideal conditions for retail expansion. SPAR, the largest voluntary retail chain in Europe, entered the China market after entering into an agreement with Shandong retailer Jiajiayue Supermarkets. The arrangement resulted in the opening of 25 new SPAR supermarkets nationwide with 15 in Shandong the end of 2007. In Qingdao, foreign retailers Jusco and Carrefour remain the major players in the market, while Li Qun Group, a local counterpart, has doubled its number of outlets over the past few years. Jusco in downtown Qingdao has the largest shelf space for imported food and beverage products in the city. It should also be noted that the Sunshine Department Store, a premier luxury shopping destination in Qingdao, opened its own supermarket in November 2006 featuring primarily imported products of which nearly 80% were of US origin. According to one of the stores major supplier's, breakfast cereal, cheese, canned soup, salad dressing and corn chips from the US are hot selling items there (please see CH6414).

A flurry of retail development swept China's Northeast or 'Dongbei' region in 2006-2007. Like other regions across China, as local economies and consumers mature in Northeast China, traditional wet markets are disappearing and rapidly being replaced by modern retail formats. However, unlike the residents of other areas in China, Northeasterners for the most part prefer to purchase groceries in bulk once a week or longer rather than to shop daily. As Gateway to the Northeast, the port city of Dalian is a major transportation hub and food distribution centre for Northeast China. The city can be characterized by highly developed and modern infrastructure as well as very high consumer incomes, compared to other cities in the Northeast. Retail formats in Dalian went through a radical transformation several years ago with multinational retailers like Carrefour and Wal-mart tapping into the excellent market conditions there along with local retail expansion. The Dalian Dashang Group remains the largest retailer in the city, with

more than 130 stores in Dalian, Shandong and the Northeast. Compared to domestic retailers, imported products have a significant presence in international invested and operated supermarkets even though imports accounts for less 3-4% of total store offerings in Dalian. According to local retail operators in Dalian, consumers there, particularly at the mid-high income level exhibit great interest in imported food products although most have limited knowledge about how to use these products. Harbin offers retailers a fast-growing market with significant consumer purchasing power. Key retailers expanding into the Harbin market include Wal-mart, Carrefour, Metro, Lianhua, Yuanda and others. The volume and diversity of imported products available in local retail formats has increased significantly in recent years although from a very low base. For example, Yuanda Supermarket expanded its imported food offerings in 2006, and increased both the volume and variety of US products which led to the development of an entire imported products section in this high-end store (see CH6406).

Table 2: 2005-2006 Major Northern City Retail Sales (Billion USD)

City	2005	2006	% of increase
Beijing	38.2	43	12.6
Tianjin	15.7	17.9	14
Qingdao	11.4	13.3	16
Dalian	10	11	10
Harbin	10.4	11.8	13.2

Source: *Global in Sight, Statistical Yearbooks 2006-2007, People's Daily Online, tdctrade.com*

### North Retail Trends

*Expansion & Consolidation:* Expansion and consolidation in the retail industry is a continuing trend. Post expects significant change to take place in the current retail market formula with fewer stores yet larger scale (volume) formats in North China. In mid-January 2007, Carrefour stated it would invest 150million Euros annually on opening new stores in China. In 2006, 21 hypermarkets were added to Carrefour's Chinese network. In August 2007, Carrefour opened its 101st store in Tiantongyuan, Beijing. The company has also has stated in plans to continue to seek acquisition opportunities across China, particularly in regions where it does not have a strong presence. The German retail giant Metro Group is looking to press further into North China's first and second tier cities. With a 24% jump in Chinese retail sales in 2006, Metro plans to open as many new stores per year as possible, with a special scouting team focusing exclusively on locating suitable properties. After opening a trial outlet on the 4<sup>th</sup> Ring Road in Beijing, Tesco revealed it plans to open 10 Tesco branded stores annually for the foreseeable future in China. Somewhat different from other retailers in China, Tesco is focusing on affluent first-tier cities like Beijing, Shanghai, and Guangzhou. In February, 2007, Wal-mart purchased a 35 percent interest in Bounteous Company Limited (BCL) which operates hypermarkets in China under the Trust-Mart banner. As a leading hypermarket operator, BCL has 101 Trust-Mart retail stores in 34 cities across China. "Through this investment in Trust-Mart we have the opportunity to expand our presence in China, one of the world's fastest growing retail markets," according to a Wal-Mart executive, "This is an important step in bringing additional scale to our China retail business and enabling us to do what we do best – serving our customers with improved service, high quality and innovative products, and lower prices."

As all these major multi-national retail operators have stepped up the pace of retail expansion, domestic supermarkets to have accelerated the pace of opening more stores. As a leading retailer in Beijing, Wu-mart operates 659 grocery stores across the supermarket, hypermarket and convenience store formats, in addition to a number of drug stores. Although Wu-mart's focus is likely to remain in Beijing, it is keen to become a nationwide operator and leading player in North China aggressively seeking acquisition opportunities to further this aim. The company plans to expand to around 1,000 stores over the next 5 years. Beijing based Chaoshifa plans to open 8-10 supermarkets during 2008. While domestic retailers accelerate expansion, they have also begun to speed up the pace of integration, making them stronger as well as larger. Store openings are still costly due to the level of investment which is required to develop distribution and supply chain infrastructure. So while retailers seek regional expansion, they have also placed development of an efficient distribution system at the top of their agenda.

*Development & Growth of High-End Retail Stores:* The rapidly rising number of middle and upper class consumers in Beijing provides a constant flow of new consumers for high end retail stores offering a wide variety of imported food and beverage products. Consumers are increasingly more sophisticated in their demands, making decisions on far more factors than price alone. The supermarket called The Market Place under the management of the CRC Group and located in the new Shin Kong Plaza in Beijing is a good example of this as fresh produce, frozen foods and ready-to-go food make up nearly 80% of store floor space. More than 50% of the produce is imported with the rest mostly organic. Most of the products are 2 to 3 times higher than comparable prices in most other retail stores. For example, a pound of California organic lettuce sells for USD 8.9, and one Kilo of Japanese beef steak at USD 120. According to the store's manager, the supermarket has successfully positioned itself in a highly niche yet profitable market by promoting high-end or trendy and healthy lifestyles, which targets middle to high income consumers. The store has enjoying strong and very promising sales since its opening in Beijing this past August.

*Food safety and Food tracking system:* The World Health Organization estimates that illness caused by tainted food cost China approximately \$4.7 billion along with another \$14 billion in medical care and productivity losses annually. China's Ministry of Health reported 144 instances of food poisoning involving 4,922 people October through December 2006, or a 42% increase over a year earlier. Many retailers in Beijing have already taken action to respond to this national concern. In August 2007, Carrefour established its own Food Safety Testing Lab in Beijing to randomly test fruit, vegetables, mushrooms, meat, seafood and noodles for sale in its stores. The tests look for at a variety of contaminants including pesticide residues, ractopamine, and nitrous acid, etc. Post understands the State Administration for Industry and Commerce plans to establish a nationwide grocery tracking system to ensure food safety. By the end of 2007, all food markets and supermarkets in cities above the county level will have to implement the system which requires invoices and documents attached to purchased commodities. In August 2007, the Beijing Wu-mart-Miyun store installed the first food tracking equipment in the city. Shoppers can now scan their purchases to find out product origin, manufacturing and expiration dates, and quality certifications, etc. Several supermarkets in Beijing such as the Market Place in the Shi Kong Plaza, and Huarun Supermarket in the Kerry Center also have installed these food tracking systems although not all of these are fully operational at the present time.

*Organic:* According to research completed by China's Ministry of Commerce, more than 60% of the country's 562 million city dwellers are willing to pay more for produce certified safe, green or organic. Retailers such as Wal-mart and Carrefour are among those that have taken advantage of the market opportunities related to this trend. Sales of organic vegetables at Wal-mart stores in Beijing soared more than 88% in 2006. "Organic food is becoming increasingly popular," according to a Wal-mart spokesperson in Beijing, "we see good growth potential in the long term." Every Carrefour store in Beijing has a special section that sells organic fruit and vegetables, although the space allocated to these sections varies based on the demographics of the particular neighborhood. However, organic food products in North China are relatively new and many of them are not up to international standards. The other challenge is that consumers have limited knowledge about organic food, and definitions somewhat such as green foods, etc.



*The Impact of the Beijing 2008 Olympics:* Among other things, Beijing's pre-Games makeover includes permanent upgrades to the city's transportation, communications, infrastructure and logistics affecting nearly every aspect of modern life in this ancient city. This has created an excellent platform for retailers in Beijing to further improve the operations efficiencies as logistics and distribution systems are being improved. In addition, Beijing began a daily food safety report mechanism as part of the "Good Luck

Beijing" one year countdown August 8, 2007, a test run for the food safety monitoring system to be put in place for the 2008 Olympic Games in Beijing. According to the Beijing Municipal Government Food Safety Office, Beijing is going to share and expand this system with other Olympics co-host cities including Tianjin, Shanghai, Shenyang, Qingdao and Qinhuangdao. The system monitors ten specific food safety factors including production, processing, the sale and preparation of food. It should be a large boost for Beijing as well as other cities in improving and enhancing food safety in retail outlets. In addition, a large increase in retail sales is expected in the run-up to the 2008 Olympics, especially in places such as Beijing and Qingdao. In fact, Beijing has identified the retail sector here as one of 7 key pillar industries expected to account for more than half of the city's total GDP in the next several years.

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