USDA Foreign Agricultural Service
GAIN Report
Global Agriculture Information Network

Template Version 2.09

Required Report - public distribution

Date: 11/7/2007

GAIN Report Number: CH7821

China, Peoples Republic of

Retail Food Sector

All China Retail Annual Report

2007

Approved by:
Mr. Wayne Batwin
ATO Shanghai

Prepared by:
David Kiefner, Sarah Wegmueller, ATO Beijing, ATO Guangzhou

Report Highlights:
China's modern food retail sector, comprising supermarkets, hypermarkets, warehouse clubs and convenience stores, has been growing by double-digit figures annually since the mid-1990's, displacing wet markets and other traditional outlets. With markets in the affluent coastal cities approaching saturation, many chains are expanding to second- and third-tier urban centers with populations of 3-10 million. While some retailers are quitting the market or going bankrupt, mergers and acquisitions are rapidly altering the national retail scene. Development in procurement systems and retail distribution networks has not kept pace however, and most retail chains still rely on independent suppliers. Outside the major urban centers, the penetration of imported products remains relatively low, although intermediate and consumer-ready products hold good potential. Growing food safety concerns in China should particularly benefit multinational retailers with their reputation for higher food safety and store sanitation standards.

Includes PSD Changes: No
Includes Trade Matrix: No
Unscheduled Report
Shanghai [CH2]
[CH]

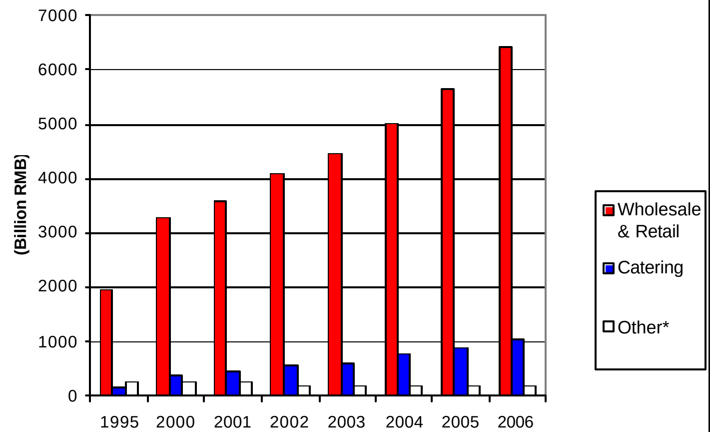
Table of Contents

I. Market Summary

I.A. Overview of the Retail Food Market in China

In 2006, total retail sales reached USD 979 billion, growing by 12.1% over the previous year. In the first nine months in 2007, China's retail sales rose 15.9 % year on year to USD 851 billion, according to the National Bureau of Statistics. The growth rate of retail sales, a major gauge of consumer spending and an indicator of market movement, was 2.4 percentage points higher than the growth rate in the same period last year. Analysts attribute the rise of retail sales to the increase of people's disposable income as the income of both rural and urban residents rose more than 13 percent in the first nine months of the year. Although modern formats and chain retailers are spreading rapidly across the country, small-scale retail continues to dominate: in 2006 sales by supermarket chain stores accounted for slightly over 2% of the total retail sales volume. This number is deceptive in that market penetration of chain retail tends to be very high in the cities and very low in rural areas. Food sales constitute a large proportion of retail sales, with food accounting for over 1/3 of average Chinese urban household expenditures.

Figure 1. Retail Sales of Consumer Goods by Sector, 1995-2006

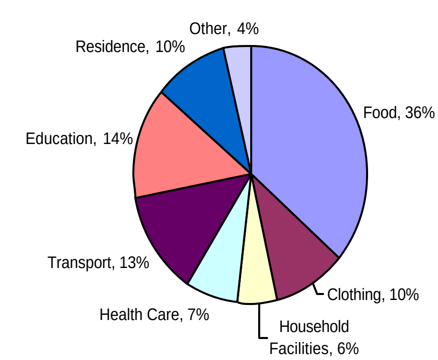


Source: China Statistical Yearbook, 2007, Table 17-3
**Beginning in 2002, direct sales of commodities by farmers were excluded from this figure.*

Food retailing in China's urban areas is undergoing a rapid modernization, although the pace varies widely by geographic location. Major urban centers in Shanghai and Guangzhou lead the way, with Beijing following close behind. Most major cities now host multiple hypermarkets and one or more international retailers. With markets in Beijing, Shanghai and Guangzhou approaching saturation, many chains are expanding to second and even third tier urban centers with populations of 3-10 million. Development in retail distribution has not kept pace, and over 90% of the products for sale, even in international retailers, are locally sourced. Outside of the cities of Shanghai, Beijing and Guangzhou, penetration of imported foods is extremely low, typically constituting less than 1% of SKUs (this issue is discussed in detail below).

Figure 2.

Urban Household Expenditures by Category, 2006



Source: China Statistical Yearbook. 2007

International retailers such as Carrefour, Wal-Mart and Metro have set the pace for retail development, and domestic and international competitors have entered these markets in large numbers, bringing the level of development close to international standards. Ferocious competition in these cities is leading the major retailers to push out into increasingly remote markets. China is an immense country and despite rapid growth and massive investment, all international retailers combined still account for only 3-4% of total grocery sales and 2.6% of all retail sales. At the same time, however, in a retail landscape populated by small shops these international chains stand out: within the ranks of China's top 100 chain stores, they account for almost one quarter of total retail sales.

Table 1. Anatomy of a Giant

Lianhua is the largest food retailer in China. Following are the basic statistics on this giant.

Lianhua at a Glance				
Division	Stores 2004	Stores 2005	Revenue 2004	Revenue 2005
Hypermarket	49	73	5039.8	7811.7
Supermarket	1340	1600	5290.7	5925.6
Convenience	1734	2050	1247.5	1659.2

Source: Euromonitor (revenue in million RMB)

Domestic retailers are developing quickly. State-owned giants Lianhua and Hualian, both based in Shanghai, remain by far the largest food retailers in China. At last count, Lianhua operated 4,109 stores, mostly small supermarkets, across China, with an ambitious goal of 8,000 stores by 2008. Although Lianhua and Hualian were merged three years ago to form Bailian, both chains continue to operate as separate entities. Much of their expansion has been fueled by acquisition of smaller chains. While this has extended their reach, it is also creating management problems. Lianhua is establishing stores in Europe, with the intention of sourcing and selling in both markets. Another state-owned giant, Shanghai Nonggongshang, which currently operates 1,857 stores, has begun to expand into cities throughout East China.

Privately-owned domestic chains are growing even more quickly. Key players include Wu-Mart in Beijing, Jiadeli in Shanghai and Suguo in Jiangsu province. Relatively small size and narrower geographic focus makes these chains quicker and more responsive to market conditions. All are expanding: Wu-Mart has expanded rapidly through a series of acquisitions of several established chain retailers in Beijing, Tianjin, and Ningxia Province and is trying to become the leading retailer in the northern China region; Jiadeli is said to be in talks with a U.S. fund manager to raise funds for a nationwide expansion; and Suguo received a boost when China Resources Vanguard (HK), a major player in South China, raised its stake to 80%. CRV is also said to have hired away a number of managers from international retailers as they beef up their management capabilities. All of the major domestic retailers are hedging their bets by fielding a variety of different store formats. Lianhua, Hualian and Nonggongshang have developed special, branded hypermarket companies to compete with international hypermarkets. All three also own convenience store chains.

The pace of development among international retailers is extraordinary. Major new players have already entered the market, starting with Tesco's purchase of a 50% stake in HyMall, which overnight gave it 32 stores in China. Hong Kong's Sincere also announced plans to enter Shanghai's crowded convenience store sector, and SPAR has received permission to establish a wholly-owned foreign enterprise in China, having already established a joint venture with the Jiejieqiang chain in Shandong. Their chain store model is likely to appeal to smaller chains looking for a competitive advantage. SPAR plans to open 15 stores in Shandong over the next three years. Another voluntary chain, IGA, has signed an agreement with Sanjiang Shopping Club in Ningbo, Zhejiang province.

Foreign retailers are rushing to tap China's fast-growing economy, large population and expanding middle class. In an acquisition worth about USD 1 billion, Wal-Mart announced in February the purchase of a 35% stake in the Bounteous Company, a Taiwan-based group that operates 101 superstores in 34 cities in China. Bounteous, which operates in China under the name Trust-Mart, will continue using its original brand name and both sides will open their new stores separately. Wal-Mart currently has 73 retail stores in China, while European competitor Carrefour has 103 stores. After the purchase is complete, Wal-Mart will exceed Carrefour in the number of superstores. The deal is part of a larger trend favoring hypermarkets in China. While Carrefour and Wal-Mart both plan further expansion in 2007, Tesco, the UK's leading retailer, is also active. Tesco's stake in its China joint venture, which operates 44 Hymall hypermarkets, has risen from 50% to 90%.

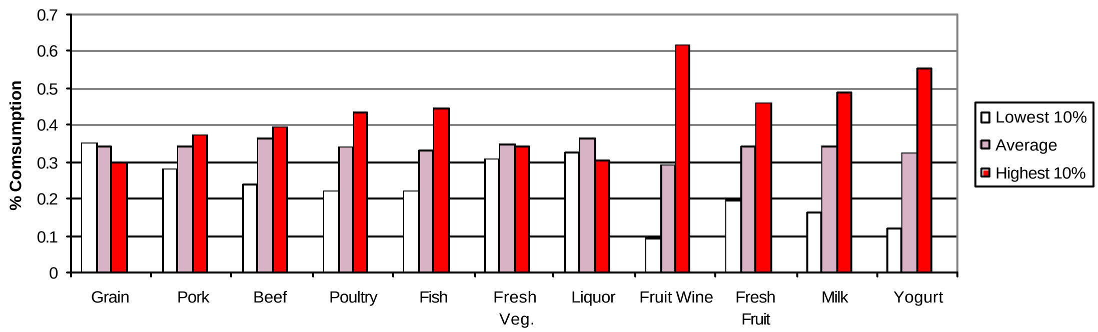
Lotus has quickly but quietly built up to 75 Supercenter stores, with a target of 100 by the end of 2008. Lotus' efforts are focused on East China, with 20 stores in Shanghai alone. Its parent company, CP Group of Thailand, has diversified investments in agricultural processing across the country, which it may be able to leverage in the future. Like many other domestic retailers in China, Lotus has no central distribution center; every store runs independently with its own suppliers. It is therefore largely dependent on local tastes and local suppliers for deciding what each store should sell.

Liberalization of China's foreign ownership regulations has added to the ferment. Prior to 2004, all international retailers were required to enter into joint ventures with local companies. As a result, most international retailers were left with joint ventures with partners they may not have wanted. Carrefour Shanghai, for example, is a joint venture with its biggest local competitor: Lianhua. While such partnerships can bring many advantages for a new player trying to establish itself in a market very dissimilar from its home market, the companies' own values, goals and strategic objectives are invariably diluted. In the wake of the reform in late 2004, international retailers either increased their stake or bought out their partners altogether. In the past year, Lotus has bought out money-losing stores in Beijing and Tianjin, Carrefour has bought out partners in Changsha and Kunming, and Metro has increased its stake in the Jinjiang Group from 60% to 90%. Wal-Mart, however, has announced that it does not intend to follow this trend, regarding the joint ventures as important to its relations with the local community.

Increased competition is forcing retailers, both domestic and international, to adapt. The strategies they are pursuing vary widely. Some (Carrefour, Wal-Mart and Metro) are resolving geographic imbalances by opening new stores in areas where they lack a presence. In 2005, Wal-Mart opened its first store in Shanghai, while in the same year Carrefour opened its first stores in Fujian (Fuzhou and Xiamen), and Metro opened its first store in Guangzhou. Another strategy, followed successfully by Taiwanese retailers Trust-Mart and RT-Mart is to invest in less well-known but fast-developing cities, avoiding the most competitive markets. (Trust-Mart and RT-Mart have also cashed in on their strong knowledge of Chinese culture and products to attract customers in cities less familiar with foreign trends). Wal-Mart appears to be following a similar strategy. While it has no stores in Guangzhou, it has 10 in neighboring Shenzhen, and a list of locations that includes Guiyang and Taiyuan, the capitals of the mountainous inland provinces of Guizhou and Shanxi, as well as a very successful venture in Nanchang (Jiangxi province).

Figure 3. Consumption of Selected Food Products by Income Group, 2006

These statistics imply that as incomes rise, consumption of many high-value products, particularly dairy and wine, is likely to increase.



Source: China Statistical Yearbook, 2007

The opposite strategy, focusing on a narrower geographic market, has proved successful for other chains, particularly domestic retailers such as Wu-Mart, Suguo and Chengdu's Hongqi. This approach allows retailers to build greater volume and build stronger distribution chains, and is particularly favored by supermarket and convenience store chains. Lotus and E-Mart appear to be following this strategy as well, focusing most of their effort on Shanghai and the neighboring cities. Metro has focused on a niche of a different sort, having tailored its cash-and-carry membership model to become a supplier to China's hordes of small family-owned restaurants and cafeterias. Ito Yokado appears to be following both a geographic and demographic niche market strategy by targeting high-end consumers in Beijing.

Retail Distribution Development

Retail distribution channels have not grown to match the number and quality of retail outlets. Roughly the size of the continental U.S., China still does not have a nationwide network of trucks, highways and cold storage warehouses that can efficiently deliver supplies from the manufacturer or importer to the store shelf. With some notable exceptions, distribution is handled on a store-by-store or city-by-city basis, with stores receiving most imports through a local distributor, often even when alternatives exist. Because of their relative size, stores are able to negotiate highly favorable terms that include free return of unsold products, high listing fees for new products, and credit terms, effectively passing all market risk onto the distributor. This gives store managers a powerful incentive to favor the local distributor over alternatives that offer less generous terms. In at least one case, an international retailer's effort to establish single-desk distribution of imports failed when their own stores refused to work with the selected distributor. A second reason for reliance on local distributors is the tendency of international retailers to expand rapidly nationwide rather than focusing on a single city or region, creating large numbers of isolated stores that lack the volume to support a dedicated distribution network. A final reason has to do with the role of relationships in Chinese business: local distributors can provide a store with a network of business and government contacts that are useful in resolving problems with minimal fuss.

Because of the high level of risk they are expected to absorb, distributors tend to be extremely conservative about new products, particularly imports. As a result, penetration of imported foods into the retail sector is low. Even in relatively affluent cities, international retailers typically carry less than 1% imported SKUs. Notable exceptions include stores in Shanghai, Beijing, Guangzhou and nearby boomtowns, which are home to both large expatriate communities and to a large number of Chinese with overseas experience. Further inland, distribution problems are further complicated by China's heavily fragmented logistics systems, which make it difficult to transport products directly from the coast to deep inland cities. One survey in Chengdu found that temperature sensitive items, such as imported poultry and meat, changed ownership as many as five times before reaching the final user.

Fragmentation among suppliers of locally sourced products, particularly of vegetables and meat, helps to perpetuate the dominant role of the local distributor. One regional chain, Suguo, made repeated attempts to source produce directly from producers or wholesale markets. The sheer volume of transactions required to meet their demand was overwhelming, however, forcing them to give up the effort. Eventually Suguo came to rely on distributors not just for sourcing, but for most aspects of marketing—essentially granting the distributor space in the store to market their products. This is changing slowly, as farmers' professional associations become more common, giving producers the ability to supply larger quantities from a single source and at a more consistent level of quality.

Exceptions to these conditions also exist. Some retailers (e.g. Metro) have centralized distribution for many imported products, and a few large distributors have negotiated more favorable terms with retail chains at the national level, in some cases waiving listing fees. As chains grow larger and handle increasing volumes, and as Chinese and foreign suppliers become more organized, the role of the local distributor in handling imports is likely to decline in the long run. Nonetheless, for now, distribution remains the key obstacle to sales of imported processed food in China's retail sector.

I.B. Sectoral Overview

Supermarkets – This is the oldest modern retail format, and remains the most common in urban China. The sector is dominated by state-owned domestic retailers, the largest being the Shanghai-based companies Lianhua and Hualian. The fastest growing brands were from the smaller chains like Shanghai Nonggongshang Group and Wuhan Zhongbai Group which both experienced 30% growth in terms of number of outlets. However, most of the chained supermarkets in China are small sized regional players, which are constrained by lack of financial resources for further expansion. Although Shanghai Nonggongshang is small in terms of outlet number (1,857), it has the highest value sales of all supermarket operators in China and therefore strong resources. A number of strong, privately owned and regionally focused competitors have also appeared in recent years, exemplified by Beijing's Wu-Mart, Xiuyijia (A. Best), Jingkelong, Beijing Chaoshifa, and Zhejiang Renti in Zhejiang Province.

Although the supermarket format is losing market share to hypermarkets and convenience stores, the actual number of stores continues to grow. In 2006, the number of supermarket outlets in China increased by 10% from the previous year to nearly 70,000, although the rate of growth has been slowing in recent years as fewer resources, particularly land, are available. The durability of the supermarket model is rooted in the demographics and buying habits of Chinese shoppers. Small apartment sizes, small refrigerators, relatively low rates of car ownership makes long trips inconvenient, and limits the amount of food that can be kept at home. At the same time, Chinese consumers are extremely sensitive to the freshness and quality of the food that they buy. As a result, most Chinese prefer to make smaller shopping trips on a daily basis, rather than going on weekly or monthly shopping expeditions to a distant superstore (although this pattern is changing with younger, urban consumers).

The key weakness of China's supermarkets lies in the poor selection and quality of produce, an item in high demand with daily shoppers. This mismatch between supply and demand has not gone unnoticed, and it is common in many Chinese cities to see impromptu wet markets form outside of some supermarkets to take advantage. Several supermarket chains are expanding their line of fresh produce in an effort to capture this business; for example, Lianhua in Shanghai has plans to change the layout of all its supermarkets to have more of an open market atmosphere with more fresh vegetables and meat products and fewer non-food products. Such stores still face steep obstacles however in sourcing the quantity and quality of produce they need. They are receiving support in this effort from local officials, who tend to regard wet markets as unsightly and unsafe, not to mention a source of untaxed commerce. The movement of supermarkets into fresh produce may prove a boon to fruit exporters, as fruit is one of the few imports that have been able to penetrate into the local wholesale markets that supply these stores.

Supermarkets have the poorest penetration of imported products of all the modern retail formats, even in major cities. The only U.S. imports routinely found in these stores are frozen corn and mixed vegetables, frozen potatoes, and occasionally fresh oranges, apples and a limited selection of wine. This is the result of both customer base and distribution systems. Chinese supermarkets cater primarily to middle-market daily shoppers, who are extremely price sensitive. By contrast, hypermarkets and convenience stores are less price sensitive, with hypermarkets appealing more to upscale shoppers (particularly those who own cars), while convenience stores make an open tradeoff between time and money. The other obstacle to imports lies in the weak distribution systems for supermarkets, which tend to rely on small-scale local distributors or local wholesale markets, or to buy directly from local manufacturers.

Hypermarkets – Hypermarkets have seen the fastest growth of any sector. International retailers are far stronger in this format than in any other. Useful statistics are difficult to come by, as chains tend to lump different retail formats together. This being said, Carrefour appears to be the dominant player, although Lianhua and Hualian also have a large number of hypermarkets. As of November 2007, Carrefour operates 103 stores in China, extending even to the far western city of Urumqi. In 2006, 21 new hypermarkets were added to Carrefour's Chinese network and the company plans to continue to open 20 new stores annually. Many of the new stores are or will be located in markets where Carrefour previously lacked a presence. Carrefour's recent overall strategy has been to increase investment and expand into more second tier cities in China, mainly because real estate in first tier cities is becoming too expensive and there are few appropriate sites still available.

Among international retailers, Wal-Mart is in second place with 84 stores, but has ambitious plans for expansion as evidenced by its acquisition this year of a 35% stake in Trustmart, a Taiwanese-owned group with over 100 stores in China. Wal-Mart first entered China in 1996 when it simultaneously opened a Supercenter and Sam's Club in Shenzhen. Until recently, Wal-Mart's development in China had been mostly limited to the southeastern seaboards where household consumption is high. In 2005, Wal-Mart finally made an entrance into Shanghai with the opening of a large suburban outlet. It was the first of three planned outlets in Shanghai, and added further momentum to Wal-Mart's drive to catch up with rivals Carrefour and Metro, both of which have an established presence in China's most prosperous city.

Metro Cash & Carry has expanded more slowly. The German-based retailer currently has 33 stores in 27 cities across the mainland, but will expand that number by 6-10 stores per year over the next 3-5 years. Metro's niche-market strategy of selling directly to restaurants and food service, however, makes it more of a player in the HRI sector than in retail, and some international retailers do not regard Metro China as a real competitor. Thailand's Lotus, by contrast, has expanded at an extraordinary pace in recent years, with an estimated 75 supercenter stores, concentrated primarily in or near Beijing and Shanghai. Stimulated by the growing demand from second and third tier cities, the company's target is to have a total of 100 stores in the next few years. This places them ahead of Tesco (UK), which entered the market in 2004 by buying a 50% share of Taiwan-based Hymall, with 47 locations in 2006, and plans to open about 10 new outlets in 2007. Ito Yokado has staked out a position as a high-end retailer, with five stores in Beijing and two in Chengdu, and plans to add five more in Beijing. The long list of other hypermarket companies operating in China also includes China Resources/Vanguard (HK), RT-Mart (Taiwan), Auchan (France), Park 'n Shop (HK), Parkson's (Malaysia), and E-Mart (Korea).

In addition to the major chains, hypermarkets often face competition (especially in Northeast and Central China) from local department store operators with one or two locations. These have evolved in the direction of hypermarkets, adding large food stores, while many hypermarkets have taken on some attributes of department stores. Hypermarkets in China tend to be somewhat smaller than their western counterparts, and very few (excepting Metro) follow the big-box format faithfully. In large cities, they are typically multi-story operations. Most act as small shopping malls, setting aside a large amount of space for independent boutiques and eateries, a habit that tends to reinforce the perception of hypermarkets as places for occasional shopping expeditions rather than daily shopping. For the hypermarket proper, the food sales area typically accounts for about half of the total area. Management within the stores tends to be quite good, but distribution has not kept pace. (Please see page 18 for more information on domestic and international retailers).

Convenience Stores – This has been one of the most dynamic sectors for development, yet is still the one with the farthest distance to go. Although the number of convenience store outlets grew at a slower pace in 2006 compared to the previous year, double digit growth is expected to continue for several more years. The industry remains overwhelmingly concentrated in Shanghai, which hosts more than half of the convenience stores in the country, plus Beijing and Guangzhou. Because convenience stores generally charge higher prices for their products, the target customer base is composed mainly of urban white collar workers who lead hectic lifestyles and students. In most small and medium sized cities, the lifestyle is not as fast as in first tier cities, which therefore reduces the need for convenience stores. The industry continues to be dominated by domestic state-owned retailers, with the largest being Quik (owned by Lianhua), Kedi (owned by Nonggongshang's Bright Dairy subsidiary) and Alldays (directly owned by Nonggongshang).

Table 2. Total Number of Convenience Stores in 2006

	No. of outlets
Shanghai	3,992
Sichuan	982
Jiangsu	817
Guangdong	652
Beijing	631
Liaoning	546
Hebei	414
Shanxi	404
Henan	130
Hubei	132
Zhejiang	1,950
TOTAL CHINA	**11,218**

Source: Access Asia from the China Chainstore & Franchise Association & NBS

These giants are being challenged on two fronts. International convenience retailers are expanding more aggressively. 7-Eleven has broken out of southern China, and now has a small number of stores in Beijing. Japan's Family Mart (connected to Ito Yokado) and Hong Kong's

Sincere have also entered the market. Other international convenience chains in China include C-Store (Taiwan) and Lawson's (a JV between Lawson's Japan and Hualian). The other challenge comes from local chains. In cities where major chains are not well established or where local governments make it difficult for regional brands to enter, local companies are filling the void. Chengdu's Hongqi, Jiangsu's Suguo and Beijing's Wu-Mart providing examples. Faced with growing competition in their home markets, retailers are

Table 3. China's 10 Leading Convenience Store Retailers by Outlets, 2006

Store	No. of Outlets	% growth YOY
Quik C-stores, Shanghai	1,959	13%
Kedi C-stores, Shanghai	1,182	10%
Haode C-stores, Shanghai	1,010	1%
Shanghai Liangyou Jinpan C-stores, Shanghai	800	20%
Cangzhou Haorizi Supermarket, Cangzhou	758	145%
Qingdao Weikejia Allied Stores, Qingdao	718	379%
Dongguan Tangjiu Group Meiyijia C-stores, Dongguan	682	95%
Shaoxing Gongxiao Supermarket & C-store Chain, Shaoxing	622	262%
Qingdao Liqun C-stores, Qingdao	620	26%
Beijing Wumei C-stores, Beijing	564	3%

Source: Access Asia from the China Chainstore & Franchise Association & NBS

expanding into new territory or seeking niche markets. Quik and Kedi in Shanghai, and 7-Eleven in Guangzhou, are both expanding into nearby satellite cities, taking advantage of their high incomes, close proximity and lack of local competitors. Other chains, like Lawson's, are seeking niche markets, targeting office workers in commercial districts, especially in eastern China.

Chinese convenience stores tend to be somewhat smaller than their western counterparts, but all have refrigerator cases and microwave ovens, and most offer a selection of hot food, typically meatballs or fishballs and tofu on skewers. The vast majority are pedestrian stores, with no allowance made for parking, although several chains have entered cooperative agreements to open gas station stores. Since gas sales are controlled by a small number of petroleum companies, these stores are actually co-located with gas stations, rather than being gas-and-go convenience stores, as in the U.S. Convenience stores also offer a variety of services, including bill payment, IP telecommunication cards and even inflating bicycle tires, all as a means of generating foot traffic.

Traditional markets – These continue to be a presence throughout China, although they are no longer the dominant factor in the larger cities. Traditional markets fall into three general categories: wet markets, variety stores (xiaomaibus), and fruit stands. Wet markets specialize mainly in fresh vegetables, meat, poultry (sold live), eggs, tofu and to a lesser extent, fruit and staple foods. Sanitary standards are extremely low, particularly for meat. Officials generally regard wet markets as an eyesore, as well as a source of both food safety problems and unregulated (i.e., untaxed) commerce. The SARS epidemic of 2003, followed shortly by avian influenza outbreaks, provided more impetus to efforts to reform or close these markets. Nonetheless, they persist. The main reason for this is a lack of alternatives for buying fresh vegetables and, to a lesser extent, meat. The selection and quality of vegetables in most supermarkets is poor, and hypermarkets are too far for daily shopping trips. Until competitive alternatives are widely available, wet markets will persist.

The other traditional formats are small variety stores (xiaomaibus) and fruit stands. The typical xiaomaibu is much smaller than even a convenience store, family owned, and stocks an eclectic mix of products. Although they face a serious challenge from convenience stores, the xiaomaibu persists even in Shanghai. While convenience chains follow standard formats and target key sites (train and bus stations, schools, hospitals, etc.), xiaomaibus are infinitely adaptable. Small size and independent ownership allows these shops to adapt to individual sites such as apartment complexes, and adapt their product selection even to match individual consumers. Like convenience stores, xiaomaibus also offer a range of services, such as bill payment and IP telecommunication card sales.

Fruit stands fill another gap left by the convenience stores, which rarely carry more than one or two types of fruit. Sales are boosted by the tradition of giving gifts when visiting friends, and most fruit stands will wrap fruit baskets to order. Fruit stands frequently carry imported fruit, usually for inclusion in fruit baskets. However, they are generally regarded as poor venues for imported products, as they are generally price driven, poorly regulated and lack the means to store fruit properly. Counterfeiting is widespread in these markets, and where a brand name adds value, it is certain to be copied. As a result, there is little room for marketing and promotion of imported products. While both xiaomaibus and fruit stands will likely continue to decline in numbers relative to convenience stores, China's high urban population densities are likely to support their continued existence for many years.

I.C. Advantages and Challenges for U.S. Products In the Retail Food Market

Table 4. U.S. Products in China's Retail Market

Advantages	Challenges
U.S. products are regarded as high in quality, and manufactured with high safety standards.	Many U.S. products are costlier than their local counterparts.
Urban Chinese consumers spend 36% of their income on food.	Overall incomes remain relatively low, with imports selling mainly to higher income groups.
Consumers are interested in new tastes.	Consumers are very price sensitive, and often unwilling to risk spending money on unfamiliar products without trying them first.
Many U.S. brands are widely recognized and respected in China's major urban markets.	Many U.S. companies have established plants in China, manufacturing their products in China with Chinese ingredients.
Incomes are growing rapidly in second and third tier cities, creating a whole new range of opportunities.	Distribution and logistics remain underdeveloped outside of the largest urban centers, making distribution of imported products to interior cities difficult.
Western foods are more widely available than ever, and growing in popularity with consumers.	Lack of knowledge about U.S. products and how to prepare them properly makes consumers hesitant to buy.
China's entry into the WTO reduced tariffs on a wide range of imported products.	Labeling regulations and sanitary restrictions limit access to the market. Enforcement of regulations is haphazard, creating confusion for exporters.
The number of qualified distributors for imported food on the mainland is growing, along with the volume of direct exports.	Many U.S. exporters continue to rely on gray market channels, reducing their level of contact with end users and understanding of the market.
Rapid growth in retail chains has created the potential for bulk sales, with consequent improvement in pricing and handling.	Purchasing by most foreign-invested chains remains decentralized, preventing them from sourcing in bulk. Close relationships between

	store managers and local distributors help to reinforce this tendency.

II. Road Map for Market Entry

II.A. Basics of Market Entry

General Guidelines

China is not a single amorphous market, but a jigsaw puzzle of small, overlapping markets separated by geography, culture, cuisine, demographics and dialects. As such, there is no single formula for success in China. The best approach to marketing a product will vary depending on the product and the specific market (geographic and demographic) being targeted. Nonetheless, there are some basic guidelines that can be applied to most cases.

1) Understand the importance of relationships. China's legal system is developing, but remains inconsistent. Enforceability of contracts varies widely, but is generally weak. Business in China instead relies heavily on personal contacts and influence (referred to as 'guanxi'). For companies with a serious interest in China, no investment will be more important to their success than the network of relationships that they establish in China. For more pointers on the role of guanxi in Chinese business culture, please see report CH4835, Chinese Business Etiquette.

2) Find a local partner and/or distributor. For smaller companies without the resources to directly market their products in China, a good distributor is critical to success. Distributors provide the network of relationships with buyers, regulators and others, that is essential to doing business in China. Unfortunately, these tend to be in short supply. ATOs keep lists of well-known distributors. Keep in mind that contract arrangements with retailers tend to place most of the market risk for new products onto the distributor, so they may require some convincing before they will take on an unfamiliar product. Specialized distributors also exist for certain product categories, most notably wine, seafood and fruit. Be careful in selecting a partner and in establishing an incentive structure: partnerships gone sour are the most common cause of business failure in China. Paying close attention to payment terms can be an important aspect of this (confirmed letters of credit are standard).

3) Know the rules. Chinese regulations are often vaguely worded, arbitrarily enforced and opaque. Your distributor can (and should) handle this for you. However, weak enforcement has made short-cutting a common practice, and exporters that rely entirely on Chinese partners for this are often unaware that their products do not conform to the rules until a problem arises. To defend against the unexpected, exporters should try to be reasonably familiar the actual regulations. Product registration, labeling and product expiry dates are the top concerns in this area. To enter the retail market, food products must receive a hygiene certificate from the local government where the product will be sold. Food products must also be labeled in accordance to Chinese government standards, with the labels pre-approved by the government. Functional or health foods must obtain a health-food certificate, and claims of health benefits on packaging or in advertising are strictly regulated. Foods containing GMO ingredients may be subject to additional labeling requirements, as are organics. Please see the FAS FAIRS reports for China on the FAS website for details (www.FAS.USDA.gov; attache reports) or the website for China's Administration for Quality Standards, Inspection and Quarantine (AQSIQ) at www.AQSIQ.gov.cn.

4) Get to know the market. As noted above, China is a surprisingly diverse place. Tastes, customs, culture, business practices and government regulations vary from place to place. Experience in other markets will not necessarily help in China, and some aspects of the market need to be witnessed to be fully understood. The best strategy is to target a specific place and get to know it well. The scope of your effort will determine whether you select a single city or a whole region. Travel to China is highly recommended to evaluate partnerships, build guanxi (see above), and identify new opportunities and potential obstacles. (Partners are frequently hesitant to mention problems in formal communications, but will be more forthcoming over informal events like dinners). FAS market briefs offer a good source of information on the market, and are available for free on the FAS website noted above.

5) Find your market niche and focus on it. China is a very, very big place. The mass market may be huge, but it is driven entirely by price and dominated by lowest-cost local producers. Better returns are to be had from targeting a specific niche. The country has a nearly infinite number of niche markets, some of them quite large. Examples include the high-end gift market, where margins are high but packaging is crucial (wine, ginseng); the expatriate market (famous brands from home like Kraft, Betty Crocker and Post); or health-conscious young parents (prunes, almonds, fresh fruit).

6) Invest (wisely) in consumer research. To outsiders, Chinese tastes can seem fickle. Tastes poorly received in the U.S. may prove successful in China, while products targeted to one market niche may end up finding their greatest success in a completely different one. To avoid unpleasant surprises and find new opportunities, exporters with a long-term interest in China are advised to research the market and test new products directly. Be careful how you invest research money, however. The quality of research by international market research firms is often not much better than that of much less expensive local companies. ATO-sponsored activities offer good opportunities to field test new products or packaging.

7) Adapt your products. Exporters should be prepared to adapt their products to the demands of their Chinese consumers. This includes flavors, packaging, prices and labeling. Small changes to flavors or packaging, based on market research, may make the product more viable in China. For example, Chinese consumers are often unwilling to buy unfamiliar products if they can't actually see them, so including a transparent window in the box or offering free samples can help sales. Products that are marketed as gifts, such as wine, should place extra emphasis on the packaging, as this is considered an important part of any gift. Many exporters seeking to break into the gift market have special packages manufactured in China, which can also help to address labeling issues.

8) Be flexible. Things don't always work as expected in China. This can be a good thing, provided you can take advantage of opportunities when they arise. Exporters who enter the market with preconceived notions of how to market their products often miss out. ATO activities routinely turn up unexpected opportunities: for premium boneless pork in Chengdu; for d'anjou pears and cherries in Shanghai; for Mexican food in Wuhan. By the same token, a product may find its best niche in an unexpected place. Washington State apples have done quite well in China despite tough competition from local products, because superior appearance and consistent quality made them the top choice for gift baskets.

9) Pursue gradual but sustainable growth. A common pitfall is the temptation to pursue explosive growth, focusing on geographic penetration rather than sustainability. This may produce impressive short-term results, but exporters with limited means may find themselves overextended very quickly. If the exporter is unable to meet the expectations of their customers, they may turn to other sources (such as local copycats or counterfeiters) or demand may collapse. Alternatively, the exporter may find themselves overly reliant on local agents that they do not know well, and who have little interest in the long-term success of the product. The go-slow approach gives exporters time to learn the markets, accumulate customer feedback, and build their distribution channels.

10) Invest in market promotion. Once in the market, an exporter's product will be competing with tens, if not hundreds, of similar products. Domestically made products will often have advantages on price, familiarity and local brand recognition, while imports can be aided by aggressive promotional campaigns. Lacking the massive marketing budgets of multinationals like Nestle or Kraft, most exporters must design and implement their marketing campaigns carefully. Attending only quality, focused trade shows for your particular market segment is a good way to start. In-store promotions are also a cost-effective way to support your product and build relationships with distributors and retailers. Above-the-line media advertising should be carefully planned, as TV and radio time is expensive and has limited reach. Exporters are strongly advised to explore joint marketing opportunities with ATOs or with a State and Regional Trade Group (such as MIATCO, WUSATA, Food Export USA/NE, or SUSTA). These events tend to be cost effective and draw more attention than standalone promotions.

Entry Strategy: Hypermarkets and Supermarkets

Hypermarkets: The hypermarket sector represents the best high-volume option for U.S. food exporters. International retailers generally have a higher level of familiarity with imported brands and products, and recognize the value of bringing new products to market and promoting them. Hypermarkets frequently source high-volume merchandise directly from manufacturers, but rarely do so with imports. Even in the largest and most sophisticated markets, they tend to source from local distributors.

The first task is to get to know your retailer. Policies vary widely among different chains: some charge listing fees, while others do not. Some require two months' credit, while others pay up front. Although these problems are usually handled by the distributor, they will affect your sales. Another reason to get to know your retailer is that hypermarkets in China tend to develop groups of favored distributors. They dislike working with unfamiliar companies unless they can offer a large number of SKUs, strong marketing support or some other sweetener. Distributors for their part, tend to be very conservative in introducing new products, due to the high level of market risk (see section I.A.). As a result, exporters with a limited product range need to work both ends of the problem at the same time, identifying a retailer that is interested in the product, and identifying a distributor that either has an existing relationship or is willing to work with the retailer.

The alternative is to identify a distributor that is willing to aggressively market the product directly to retailers, and count on them to find markets for your product. This requires that the distributor be fully convinced of the marketability of the product, given their high level of risk. Distributors generally fall into one of two categories. The largest distributors tend to have longstanding relationships with the major retail chains, and can source in larger volumes and place products in a larger number of stores. However, they also tend to carry a large number of SKUs, and cannot dedicate resources to marketing any one particular item. Specialty distributors tend to be focused on one area or product type. Although they sometimes lack the volume and connections of larger distributors, they tend to be more aggressive in marketing products and better at identifying and selling into specific niches. The quality of these smaller distributors varies widely, however, and exporters need to be extremely careful in selecting a partner.

Products that are already in the market but being sold mainly through gray channels or sub-distributors tend to be the most attractive to distributors. A handful of retailers also act as distributors. Although they tend to provide less marketing support, they can be an effective means of getting product to retailers that have already expressed an interest, but cannot handle the import formalities themselves.

Supermarkets: Imported food is relatively rare in Chinese supermarkets. Products that do well in this sector tend to be commodity products already widely available, such as fresh fruit, frozen vegetables and nuts. Supermarkets rarely if ever import directly, or even buy directly from an importer, tending instead to rely on wholesale markets and local manufacturers or distributors. Stores with a significant expatriate community nearby are likely to carry imported breakfast cereals and a perfunctory selection of imported sauces (especially pasta sauce) and seasonings. The best possibilities are in the smaller, privately held chains, which are more likely to see the value of high-margin imports and tend to have better integrated distribution systems. Such chains may carry products as varied as wine, exotic fruit (avocados, in one case) or confectionery, but only in low volumes. Even so, price will remain a consideration. State-owned supermarket chains generally have less integrated management and distribution. Opportunities exist, but only on a fitful basis with a small number of stores, and only for products already present in the market. For either state-owned or private supermarkets, direct contact with company officers is the best means of introducing a new product.

Entry Strategy: Boutique Stores

This category includes expatriate-focused gourmet stores and specialty stores for organic foods, wine, cheese and similar high-end products. These stores have proliferated in recent years, particularly in Beijing and Shanghai. Although volumes tend to be quite small, price pressure is not as high as in the hypermarkets. In addition, managers tend to be more aware of famous brands and actively search for niche products not otherwise available in the market. Many high-end and specialty products first enter the Chinese market through these types of outlets before moving on to larger venues. A handful of these companies also include import/distribution operations, and can assist exporters with issues such as labeling and product registration. Otherwise, exporters will need to identify a good distributor. In the case of high-end and specialty products, HRI-focused distributors (who are familiar with the products but may lack experience with labeling issues) may be as helpful as larger retail-oriented distributors (who often lack experience marketing high-end products), particularly in emerging city markets. Because of the small scale and highly varied nature of this market segment, interested exporters should contact the relevant ATO for a list of potential venues.

Entry Strategy: Convenience Stores

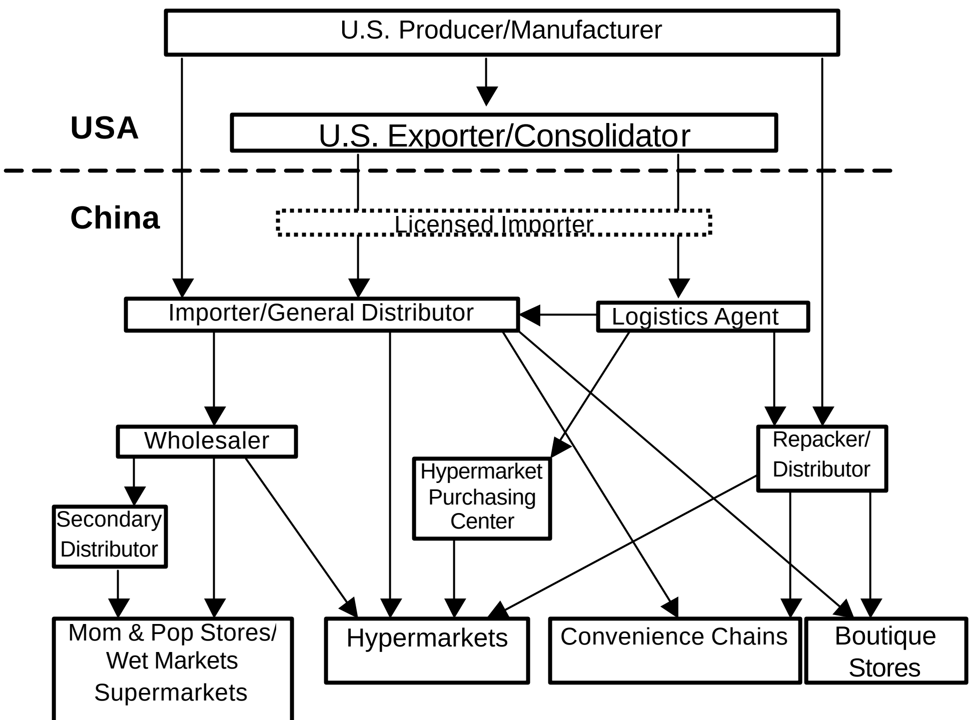
Convenience stores represent the greatest untapped potential. The sector is very new, and most chains have cutting-edge management systems and integrated distribution. The industry also tends to be highly concentrated geographically, giving chains larger bulk sourcing capabilities. Competition is also driving a rapid move toward specialization, in turn creating new niche opportunities. Import penetration however, tends to be relatively low, despite a high level of interest on the part of several chains. Being largely domestic companies, management at convenience store chains tends to be less familiar with imported products than their counterparts in the hypermarket sector. A second difficulty faced by imports is packaging: convenience stores typically require smaller package sizes, being focused mainly on single-serving products. Exporters are advised to open discussions directly with chain officials to identify products with potential, and ensure that packaging meets their needs. Then the exporter will need to identify a local distributor that can handle the import paperwork and labeling issues. One alternative to this is to work with an importer/repacker, who can import in bulk, then package the products in China with Chinese labels and packaging appropriate to the convenience market. This strategy has proven extremely successful for U.S. prunes. Competition also tends to make convenience stores somewhat conservative about pricing, though ATO/Shanghai's experience indicates that chain managers are more price sensitive than their customers.

II.B. Market Structure

Distribution by Market Type

Distribution varies widely throughout China based on geography, product type and retail sector. As a general rule, the three cities of Shanghai, Guangzhou and Beijing have the best infrastructure and the largest number of experienced distributors. Increasingly, those systems are being extended to the large webs of satellite cities surrounding Guangzhou and Shanghai. Ports in these cities offer a growing array of services, including bonded storage (with temperature controlled facilities, if needed) and online inventory tracking. Some have duty-free industrial zones where products can be repackaged or further processed, with duty paid only on the original import value, and only after products leave the zone.

Figure 4. Imported Goods Distribution Chain: Major Port

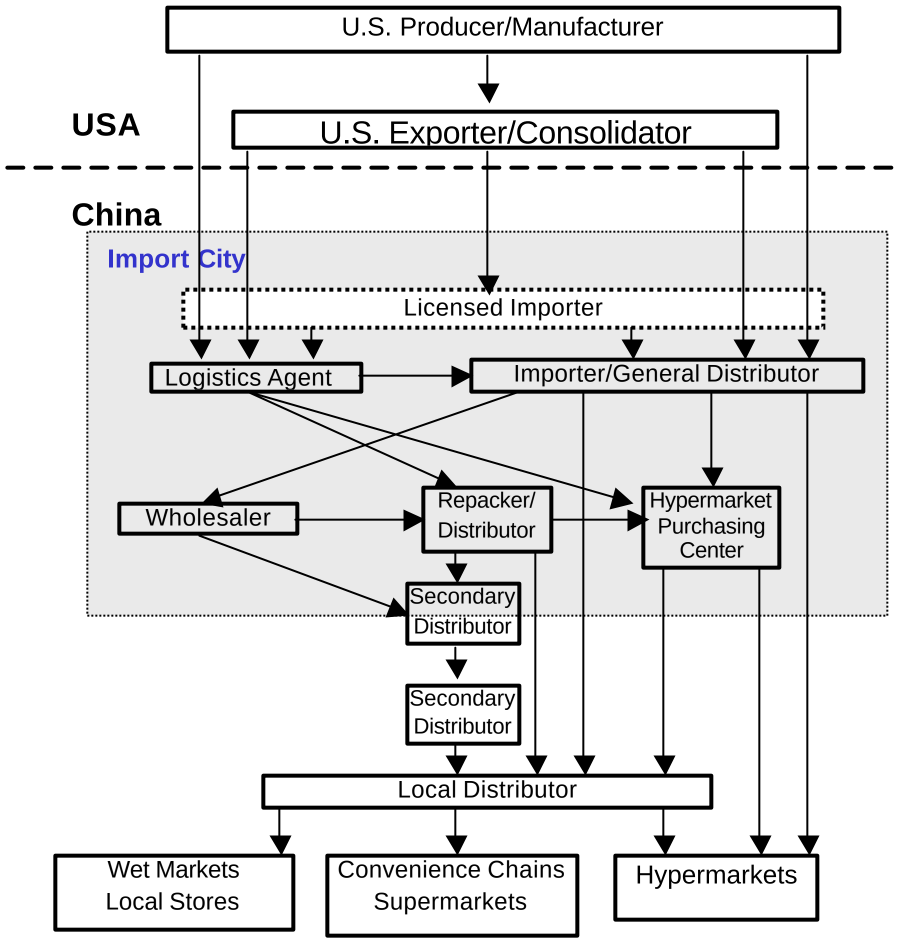


Source: ATO/Shanghai research

Other major cities along the eastern seaboard, beyond the reach of the 'big three,' generally have good logistics infrastructure, but most still rely on one of the 'big three' as an entry point for imports. The number of distributors handling imported products in these cities is usually limited. These tend to be good markets for commodity products such as meat, poultry, fruit and seafood, as well as sauces, condiments and wine.

Deeper inland, there are a number of large cities with good market potential. Logistics can be problematic, but improvements in the national highway system have made trucking direct from Shanghai or Guangzhou far easier than it was just four years ago. As a result, high value and sensitive products shipped by truck directly from the importer to a local distributor do surprisingly well, while lower value and shelf-stable products that ship on local roads through conventional distribution chains face more difficulties. Distribution in these cities is generally underdeveloped. Many cities have only a single distributor for imports, particularly high-value or temperature sensitive products. Products going through conventional distribution channels typically change hands numerous times before reaching their final destination. Distribution channels for HRI tend to be better developed, and may be the best place to start for exporters seeking to develop new markets.

Figure 5. Imported Goods Distribution Chain: Emerging City via Major Port



Source: ATO/Shanghai research

Distribution also varies widely by product type. Channels for shelf-stable grocery products tend to be the most heavily fragmented and the most dependent on the good graces of local distributors. This is partly because market risk is perceived to be higher: although shelf stable, the number of SKUs tends to be high and turnover low compared to other product categories. Hence the risk that a product will not sell (and the distributor will have to accept a return) is higher. Meat, poultry and seafood also face fragmented distribution, but the combined demand from HRI and retail venues is sufficient to warrant special arrangement for these high-value products. Fresh fruit appears to have the best distribution, working through a patchwork of wholesale markets and specialized distributors that works better than it should. Imported frozen corn and mixed vegetables are almost universally available, reinforcing the notion that the problem is less one of logistics than of distribution. Wine deserves special mention, due to the presence of a community of specialized distributors, some of whom act as exporter, importer and distributor all in one, taking product direct to retailers.

Industry Profiles

Statistics on China's food retail industry have serious shortcomings, for a variety of reasons. Mergers, buyouts and cross-investment, combined with the effects of China's previous requirement for foreign companies to work through joint ventures, have created a hopelessly tangled web of ownership. It is difficult to be certain whether revenues do or do not include income from joint ventures or subsidiary chains. Store numbers are less opaque, but still present problems. Many retailers operate a range of different store formats, and it is not always clear whether a number includes only hypermarkets, supermarkets, or convenience stores, or some combination of the three. Lastly, the retail sector is expanding at such a rapid pace that store numbers can change on a weekly basis. Keeping these difficulties in mind, the following table provides a rough outline of the current state of the retail industry.

Company Profiles

Table 5. Leading food retailers in China: 2006

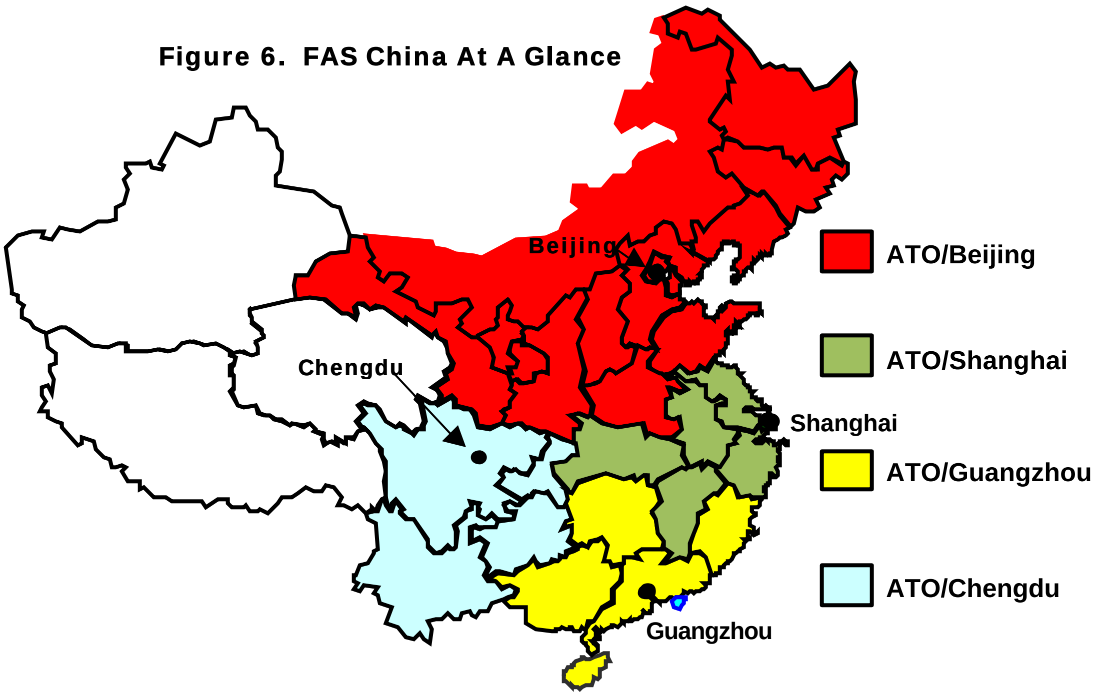
Company	Ownership/ Headquarters	Business Line	Stores (no.)	Sales (¥ billion)[1]
Domestic Companies				
Lianhua	China SOE[2]	Super/Hypermkt/ Convenience	3913	44.0
Wumart	China Pvt	Supermkt/ Convenience	728	23.1
Suguo	China SOE[3]	Supermkt/ Convenience	1612	22.3
Beijing Hualian	China SOE	Hypermarket	76	21.2
Nonggongshang	China SOE	Super/Hypermkt/ Convenience	1857	19.6
Shanghai Hualian	China SOE	Super/Hypermkt/ Convenience	1955	15.0
Xiuyijia (A. Best)	China Pvt	Department	99	14.3
Jingkelong	China Pvt		171	6.1
Kedi	China SOE	Convenience	1171	2.4
Zhejiang Renti (C&U Supermarket)	China Pvt	Supermarket	226	1.9
Beijing Chaoshifa	China Pvt	Supermarket	51	1.7
Multinational Companies				
China Resources Vanguard	Hong Kong JV	Hypermarket	2250	37.9
Carrefour	France	Hypermarket	95	24.8
RT-Mart	Taiwan JV	Hypermarket	68	19.6
Wal-Mart	United States JV	Hypermarket	71	15.0
Trust-Mart	Taiwan JV	Hypermarket	101	14.0
Lotus	Thailand	Hypermarket	75	13.5
Metro	Germany JV	Hypermarket	33	9.4
Tesco	United Kingdom JV	Hypermarket	47	9.3
Auchan	France	Supermarket	16	6.2
Parksons	Malaysia	Supermarket	38	6.2
Park'n'Shop	Hong Kong	Supermarket	44	4.7

Source: China Chain Store & Franchise Association 2007

[1] Sales include food and non-food items
[2] SOE= State-Owned Enterprise
[3] Joint venture with China Resources Vanguard

II.C. Regional Market Profiles

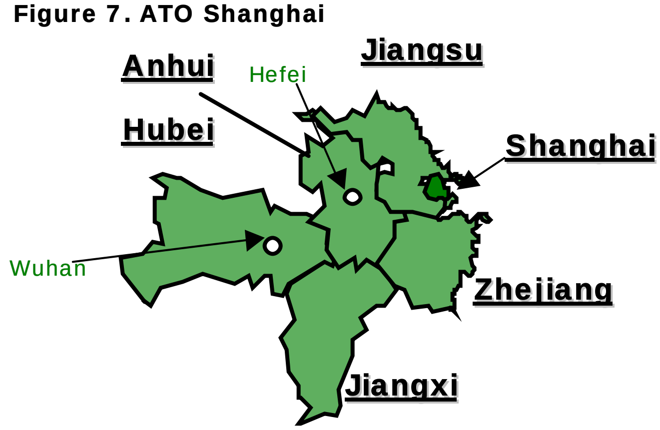
Figure 6. FAS China At A Glance



As noted many times before, China is a diverse place, and fragmented distribution and logistics systems help to reinforce existing divisions. To assist exporters in dealing with these divisions, FAS maintains five offices in China, with Agricultural Trade Offices in Beijing, Shanghai, Guangzhou and Chengdu (opening December 2007), and an Agricultural Affairs Office in Beijing. Individual market profiles for each region are offered in the following sections.

Shanghai Region

Figure 7. ATO Shanghai



The city of Shanghai is a massive market unto itself, with a population estimated at 20 million, and incomes among the highest anywhere in China. As costs in the city have risen, the economy has begun to shift away from manufacturing and into financial and management services. Manufacturers seeking to escape high costs in the city while taking advantage of the infrastructure and massive consumer base have created an economic boom in the surrounding region. The city is located at the center of a web of economic development that includes the provinces of Zhejiang and Jiangsu, and is collectively referred to as the Yangtze River Delta (YRD). This region accounts for nearly 1/3 of mainland China's GDP. Massive infrastructure investment has led to major improvements in logistics and drawn the region closer together. The opening of the Yangshan deepwater port facility last fall is expected to make Shanghai the world's largest container port within the next few years. Shanghai's large expatriate community (estimated at 500,000) is dominated by Taiwanese, who bring with them a familiarity with foreign brands and a taste for U.S. and Japanese foods.

Shanghai's retail sector is well developed, and home to a large number of supermarkets, hypermarkets and an extremely strong convenience store sector. Supermarkets remain the dominant, and oldest, modern retail format, with relatively weak management and infrastructure. Supermarkets are losing ground to hypermarkets and convenience stores. This loss in market share, however, is counted in growth not captured: new stores continue to open. The supermarket format is quite durable owing in part to Shanghai's high population density (the highest in China and one of the highest in all of Asia), which makes it possible to have a small supermarket within walking distance of virtually any place in the city.

Table 6. Top Players in Shanghai Retail, 2005

Company	Total Outlets	Outlets in Shanghai	Sales Volume ($million)
Lianhua	3,786	2,105	5,106
Carrefour Hypermarket*	101	8	3,516
RT-Mart	32	6	2,594
Nonggongshang	1,572	1,362	2,333
Hualian	1937	1362	2,268
Lotus	21	19	1,166
Metro	27	4	1,006
Hualian GSM	22	17	538
Shanghai Lianjia	8	8	526
Shanghai Homegain	122	104	268
Jieqiang Tobacco, Sugar & Wine	443	210	210
Auchan	4	4	182
Watson	28	28	83
Jiajiale	37	37	40

*Source: Shanghai Statistical Yearbook, 2006 (most recent year available), except for * derived from Group Carrefour. Note that CCSFA and Shanghai Yearbook numbers for Lotus differ sharply.*

Hypermarkets

Hypermarkets constitute the single best retail venue for imported products. International chains such as Carrefour and Wal-Mart are both familiar with the products, and count large numbers of expatriates in their customer base. Most are experienced in promoting new products, and flagship stores like Carrefour's Gubei store or Lotus' Superbrand Mall store in the Pudong area have it down to a science. Despite this, imports rarely constitute more than 5% of total SKUs in even the high profile stores. As elsewhere in China, the most decisive component in hypermarket food promotion is free sampling. Shanghai consumers are cautious rather than impulsive buyers, and will rarely spend money on a product they have not had a chance to try. Hypermarket promotions also come with many strings attached: most charge listing fees and demand that promoters be provided at the distributor's expense (some even charge fees to have the promoters on their premises). Other conditions include accepting returns of unsold products at the end of the promotion. (These issues are discussed in detail in Section I.A.).

The hypermarket industry in Shanghai has expanded quickly, reaching an estimated total of 121 stores by the end of 2005. The sector is dominated by international retailers, with over

67 outlets in Shanghai accounting for 76% of the sector's combined 21.4 billion RMB in sales. Hypermarkets are eating into market share for supermarkets as growing ownership of cars and larger refrigerators make bulk shopping trips more practical. Management of these stores is generally modern, and SOE hypermarkets such as Lianhua's Century stores are bringing in foreign experts to upgrade their management to compete with the international retailers.

While Carrefour continues to dominate at the high end, with 12 hypermarkets presently in Shanghai alone, Lotus has quietly expanded and now actually has 20 stores in Shanghai, although turnover for these stores is lower than for Carrefour stores. Wal-Mart finally established a presence in the city by opening its flagship Nanpu store in late 2005 and added two more stores in 2006. Tesco's purchase of 50% of Taiwan-owned HyMall has given it a foothold in Shanghai, but experience with Hymall indicates that Tesco may need some time to integrate its management with HyMall's. Korea's E-Mart, which currently operates five stores in Shanghai, also plans to ramp up its efforts, having recently opened a store in Tianjin and with another scheduled to open in Shanghai in 2006. E-Mart's final target is 33 stores in the region, ten of them in Shanghai. A total of 14 retailers have hypermarkets in Shanghai, including Auchan, RT-Mart, Trust-Mart and Hyodo. Most have announced plans for further expansion.

Under pressure from competition, hypermarkets are seeking ways to differentiate themselves. Wal-Mart has announced a cooperative effort with a Chinese pharmacy company to provide pharmacies in their stores, and Carrefour is in talks to do the same. Lotus' flagship store in the Superbrand Mall last year became the city's first 24-hour hypermarket. Although Carrefour's flagship Gubei store quickly extended its hours, few others have been willing to follow suit. Most hypermarkets in Shanghai now stock a wide range of ready-to-eat products such as rotissiere chicken, and have in-house bakeries. House brands are also becoming popular as retailers seek to cash in on their reputations. Carrefour leads the way through heavy house branding in its Dia discount stores. Chinese hypermarkets are following suit, led by Century Lianhua.

Table 7. Structure of Shanghai's Food Retail Sector, 2005

Sector	Total Sales (million RMB)	International Retailer Sales	International As % of Sales
Supermarket	67,900	630	1
Hypermarket	21,400	16,300	76
Convenience	9,300	630	7

Source: Shanghai Daily

Metro relies on its niche-market strategy of targeting small and medium sized restaurants, effectively positioning itself as an HRI wholesaler and distancing itself from competitors. To this end, Metro has added a training kitchen to its facilities in Shanghai. ATO has worked with Metro on a number of occasions, arranging for USDA cooperators to provide training in the purchase, handling and use of U.S. food ingredients, while Metro provides facilities, and recruits from their customer base of restaurants. Parkson's, with a presence across China, offers relatively small spaces for food sales in their department stores, but focuses on very high-end products, including some imports.

Supermarkets

Supermarkets have the lowest penetration of imported products of all the modern retail venues in Shanghai. U.S. food products in these venues are typically limited to frozen corn and mixed vegetables, frozen potato products and occasionally fruit (apples or oranges). Other items tend to appear on a haphazard basis: past checks have turned up breakfast cereals, low-end wines and California avocados. The sparse selection of imports is rooted in the customer base of these stores, which focus on working class shoppers, who are notoriously price sensitive and less inclined to try new products than the more well-heeled customers that frequent hypermarkets and convenience stores. Distribution is also a problem, as stores tend to source from local distributors, directly from manufacturers, or from local wholesale markets.

The supermarket sector in Shanghai is dominated by domestic companies. The only foreign-invested supermarkets in Shanghai are Tops and Watson's, which combined registered only 730 million RMB in sales in 2005, out of a sector total of 67.9 billion RMB. State-owned companies are dominant, with Shanghai serving as headquarters to three of China's top ten food retailers: Lianhua, Hualian and Nonggongshang, all state-owned. Although Lianhua and Hualian were nominally merged three years ago to form the behemoth Bailian, the largest retailer group in China, they continue to operate as distinct (and competitive) chains. Bailian appears to be more focused on rationalizing its diverse portfolio, and developing its shopping mall management component. Both Lianhua and Hualian have expanded aggressively through acquisitions of other chains, leaving both companies with the challenge of incorporating them into already weak SOE management structures. Inspired by foreign-invested companies (Dia carries 1,000 SKUs of house brands), the Chinese chains are paying greater attention to branding, and most now carry a substantial number of house brands.

Despite the dominance of SOE retailers, Shanghai has several smaller, privately owned chains. The largest of these, Jiadeli, operates some 130 stores in the Shanghai area, and is actually larger than Nonggongshang in the supermarket sector. All are seeking ways to survive in an increasingly competitive landscape. Industry sources claim that a U.S. fund manager plans to buy a 32% stake in Jiadeli, injecting a large amount of cash to take the brand nationwide. Another local chain, Jieqiang, is cooperating with China Life Insurance to sell travel insurance policies through their stores. Lianhua and Alldays convenience stores are also working with China Life on this project. Most supermarkets have imitated the convenience chains by offering a wide range of additional services such as bill payment, at a nominal fee.

Shanghai's supermarkets are small and focus on daily necessities, but are weak on fresh produce. It is not uncommon to find vegetable sellers with blankets covered with vegetables for sale outside of supermarkets, and fruit stands tend to locate close to supermarkets. This started to change after the SARS and avian influenza scares, and the more recent food. City officials throughout China tend to regard informal and wet markets as unsanitary eyesores. In Shanghai, after years of unsuccessfully trying to shut down informal markets, they are now attacking the other end of the problem by encouraging supermarket chains to create 'fresh' supermarkets, expanding the floor space dedicated to fresh products from less than 1/3 to over 1/2. Shanghainese place an extremely high value on clean, well-lighted venues, and it is highly likely that the presence of a reasonable alternative to wet markets will do more to hasten their decline than efforts to force them to close. To date, only Nonggongshang has made a public commitment to this strategy, converting over 100 (current numbers are not available) of their stores. Supermarkets throughout the region (including Suguo) appear to be moving in this direction, but are being slowed by problems in sourcing large quantities of quality product.

Aggressive competition from Carrefour's Dia discount stores may push more supermarkets to carry fresh products. Dia carries many of the same staple goods as supermarkets at deep discounts, but does not carry fresh products. The threat from Dia should not be understated. Although Carrefour has opened only 150 of these stores in Shanghai to date, they planned to reach 300 in 2006 and open new stores at a rate of 20 per month after that. Dia stores are small, carrying a limited range of products, mostly house brands. Anecdotal information indicates that the Dia stores are competing quite well. Nonggongshang has also established a chain of discount stores called ‘One Price’ or ‘5 Reminbi,’ offering most products for less than $1. They planned to open a total of 160 free-standing discount stores by the end of 2005.

All three major SOE supermarket chains (Lianhua, Hualian and Nonggongshang) have hedged their bets. Lianhua owns the Quik convenience store chain and is the partner in Carrefour’s Shanghai joint venture. Hualian is the JV partner with Japan’s Lawson’s in their chain of convenience stores in Shanghai. Nonggongshang owns the Allday’s chain of convenience stores, as well as the area’s largest dairy company, Bright, which owns yet another major convenience store chain, Kedi. All three have also opened branded hypermarkets in and beyond Shanghai, and Lianhua is putting a particularly strong effort into its Century Lianhua hypermarkets. Although Nonggongshang’s market share has slipped, it is attempting to expand its reach to match Lianhua and Hualian, opening NGS hypermarkets in distant cities like Nanchang, with mixed results.

Convenience Stores

Convenience stores are rapidly becoming a more favorable environment for imported foods, as stores seek ways of distinguishing themselves, while the higher prices for higher-quality imports provide a better per sale return. Again, Lawson’s is leading the way in this field, having worked with ATO/Shanghai and U.S. product distributors in 2005 to launch a U.S. food festival in selected stores, promoting Sun Maid Raisins, Planter’s Nuts and macadamia nuts from Hawaii, among other things. The results made clear that products need to be adapted to the convenience store format, most particularly in terms of reducing package sizes. One of the most successful suppliers of U.S. product to the sector imports U.S. prunes and re-packs them into single-serving packets that are sold to students at 1 RMB (about 12 cents) apiece. U.S. frozen potato products, cooked and sold ready-to-eat, have also been successful in this format.

Shanghai’s convenience store industry is by far the most developed in the country, with the city playing home to an estimated 4,500 convenience stores—nearly half of the national total. One source estimates the number at 1 store per 3,800 residents (not including immigrant workers), comparable to saturation levels in Japan and the U.S. Despite this, the sector continues to grow. Shanghai’s convenience sector is overwhelmingly dominated by subsidiaries of the giant SOE supermarket chains: Quick (Lianhua), Alldays (Nonggongshang), Kedi (Nonggongshang via its Bright Dairy subsidiary) and Lawsons (a JV between Hualian and Lawsons Japan). However, new investment is coming from international convenience chains. Japan’s Family Mart entered the city two years ago, and now has in the range of 120 stores in Shanghai, with plans for 350 by the end of 2006. Hong Kong’s Sincere has announced plans to enter the market with 300 stores by the end of 2006. Aside from Family Mart and the Lawson’s JV, Taiwan’s C-Store franchise is the only international convenience retailer currently with stores in Shanghai. Stores compete aggressively for good locations, and it is not uncommon to see three different convenience stores within 100 feet of each other in prime areas.

Management in convenience store chains is probably the best of any retail sector. All stores have refrigerator and freezer sections, microwave ovens, and most have a selection of hot snacks (mostly meatball or tofu on skewers). More to the point, most chains have integrated distribution systems, including fully automated, real-time inventory and ordering. The main exception is for fresh products (mostly dairy and prepared meals) which are often distributed directly by the manufacturer. Store layouts are highly standardized, although some chains have developed more complex systems that customize product selection to the peculiar location based on past sales patterns.

Ferocious competition has spurred efforts to innovate and to target niche markets. Quik and Kedi have both entered into deals with gas station operators to open markets in their stations. Lawson's pioneered efforts to target white collar employees and service staff in shopping districts with high-quality Japanese style lunch boxes. Kedi is now following this lead with a 'Korean Taste' campaign, providing all three daily meals in Korean styles and a selection of other Korean food under a house-brand label. Family Mart expects to benefit from superior management and technology (they may be surprised by the local competition). As noted earlier, nearly all convenience stores offer a range of services to draw foot traffic, with Alldays ushering the latest innovation by providing China Life travel insurance policies at their stores. 21 Century went a different direction, merging with the Maya music chain to create food and music stores.

Boutique Stores

Boutique and specialty food stores in Shanghai have multiplied, becoming a force unto themselves. Expatriate grocery stores continue to expand. The most venerable, City Supermarket, continues to be one of the best single venues for imported food in Shanghai, and now does significant business as a distributor of imports to other stores. Chiro Group's (Singapore) Pines The Market stores are providing City Supermarket with competition, carrying a high-end selection of gourmet products. Another trend is in specialty wine retailing: several specialty wine outlets have opened (not to be confused with the traditional state-owned hard liquor and tobacco stores). The most notable is Cheese and Fizz, which features a wide range of wines and imported cheeses. Yet another trend is in organics. While City Supermarket markets its own brand of locally grown organic vegetables, and also sells those products to other retailers, California's O-Store opened its first all-organic food store in Shanghai in 2005, with ambitious plans as both a retailer and distributor of imported organics. O-Store imports mainly from Germany, Japan and the U.S.

Beyond Shanghai

The immediate area surrounding Shanghai (the Yangtze River Delta, or YRD) is a beehive of industrial and commercial activity. In the key cities, retail development is already well advanced. Suzhou and Hangzhou are home to Carrefour and other hypermarkets (including Auchan, Lotus, RT-Mart, Tesco/Hymall and Trust-Mart) and Quik, Kedi and C-Store convenience stores. Hypermarkets throughout the region source imports through Shanghai, taking advantage of the region's outstanding logistics and Shanghai's large community of experienced food importers. The supermarket sector in these cities is typically dominated by either Lianhua, Hualian or Nongongshang, but with a preponderance of independents (with the notable exception of Nanjing's Suguo).

Figure 8: The Yangtze River Delta

The capital of Zhejiang Province, **Hangzhou** is home to Carrefour, Metro, Lotus, Auchan, Wal-Mart, Lianhua, and Hymall, among other super- and hypermarkets. Hangzhou's retail market is doing far better than expectations: in an ATO-organized nationwide retail promotion involving 24 Carrefour stores, the Hangzhou store ranked 7th in sales: ahead of Guangzhou and following stores only in Shanghai (4 stores) and Beijing (2 stores). In addition, the Hangzhou store was extremely aggressive to recruit distributors and products for the event, and ultimately carried far more items than originally agreed. (Please see CH7819).

Suzhou's market is steadily growing, and a privately-owned cold chain already exists, with temperature-controlled warehouses and delivery trucks. Metro has established itself in Suzhou as the destination for one-stop shopping, and its membership is already 130,000 strong. To further stimulate market growth, the city's infrastructure is developing at light speed. Several new highways were built recently; bridges cross the Yangtze River, and a light rail system has been scheduled for completion in 2008. (Please see CH7816).

Development is now moving on to a third tier of cities. Particularly notable are **Wuxi**, which has become a major distribution center for seafood and meat products in the YRD area; **Ningbo**, which has average incomes on par with Shanghai but a less well-developed retail sector; and **Nanjing**, the capital of Jiangsu province.

Nanjing's market and imported product consumption have increased substantially. Based on ATO/Shanghai interviews, major retailers including Metro, Walmart and Carrefour stated that the higher the percentage of imported food items in their store, the better their sales, indicating the high potential for imported food in Nanjing. Nanjing is also home to Suguo, a retail giant which dominates more than fifty percent of the city's market share.

Although **Wenzhou** is one of the richest cities in China, its market for foreign imports is still relatively underdeveloped. Wenzhou was only opened to international retail giants in 2006 and while its market was slow to open, the retail sector is growing quickly. The ATO/ Shanghai is planning a multi-level promotion in Wenzhou in May 2008. According to the Wenzhou Retail Association, a "Sourcing Alliance" consisting of all the important retailers in Wenzhou will be organized in 2008 to consolidate the sourcing of imported food products, to strengthen the bargaining power of Wenzhou retailers against food importers. (Please see CH7814).

Many of these cities are home to relatively strong independent chains, particularly those further from Shanghai. Voluntary chain IGD has entered into talks with Ningbo's Sanjiang Shopping Club. Interestingly, Sanjiang is linked through a voluntary association to Shandong's Jiajiayue, which is working with voluntary chain SPAR. Local officials in China tend to protect local businesses aggressively, a fact that could work to the advantage of voluntary chains, particularly in the community of wealthier cities with distinct identities that lay at the edges of the YRD, such as Wenzhou, Nanjing and Ningbo.

Farther inland, the picture becomes less clear. Retail development has progressed at different paces and with widely differing results. Most large cities host at least one international hypermarket, typically with several local imitators and independent supermarket chains. The following section touches briefly on the key markets and offering some perspective as to the degree of variation.

Kunming, in Yunnan province, developed at an astounding pace, ultimately attracting 10 international hypermarkets, including Wal-Mart, Carrefour, PriceSmart and Metro, in the space of a few years. This pace exceeded local demand, however, and many of the stores have languished with a few closing. **Chengdu**, by contrast, developed more slowly, and is now home to more than 6 international hypermarkets, all of which appear to be doing well. One international retailer referred to Chengdu as the only city in West China where they routinely turned a profit. Incomes are generally lower than in coastal cities, but the residents of Chengdu appear to have a very high propensity to spend, particularly on food. ATO/Shanghai's efforts with both Ito Yokado and Carrefour stores in this city were immensely successful. Nearby **Chongqing** is less well developed. Although it has strong potential for the future, the best opportunities appear to be in the HRI sector.

Wuhan, in Hubei province offers a mid-range prospect. It has a reasonably well-developed retail sector, with Metro, Carrefour and Wal-Mart all represented. As income levels rise throughout urban areas in China, potential markets are emerging in growing cities everywhere. In September and October 2007, the ATO/Shanghai led a multi-level campaign promoting U.S. food products in Wuhan, in cooperation with the Hubei Culinary Association and Wuhan Wushang Bulk sale Chain Co. Ltd. As the sales revenues generated in the Wuhan catering industry rose by 17% in the first half of 2007, the ATO's promotion further promulgated the city's potential market through a seminar, cooking demonstration and contest, tabletop shows, food tasting reception, one-on-one meetings with local traders, and two week in-store promotion. The city itself seemed receptive to American products, and with the rapid increase of supermarkets, hypermarkets and convenience stores, as well as more than 40,000 restaurants, it has a reasonably developed retail sector.

Wal-Mart's remarkable success in **Nanchang**, the capital of Jiangxi province, provides a good case study for retail in China. Nanchang was not generally regarded as a retail market in the same class as Kunming or Chengdu. However, close cooperation with local officials netted Wal-Mart a prime location, just as the city launched a major redevelopment effort, making for a major success. The success of this venture is all the more striking given the relatively weak performance of Nonggongshang's NGS hypermarket, established several years earlier in the same city, and demonstrates the value of local market knowledge.

Beijing Region

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 3rd 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 Manage post 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 8. 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. (Please see CH7417).

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 Carrrefour 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 Dailan 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 9. 2005-2006 Major Northern City Retail Sales (Billion USD)

City	2005	2006	% 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 4th 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 there 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.

South China Retail Market Overview

Southern China's retail industry is widely considered to be at the forefront of the nation's rush towards a developed market economy. In many ways the retail food sector is leading this charge as an increasing number of Chinese purchase their groceries in modern international style hypermarkets and supermarkets instead of traditional wet markets.

Retail sales for South China were estimated at USD227 billion in 2006, up 15.3 % from the previous year. Food accounts for 36% of this total retail figure, and demand for imported foods is rising. However, imported foods account for less than 5% of total food sales in this region.

Figure 10. Guangzhou Region

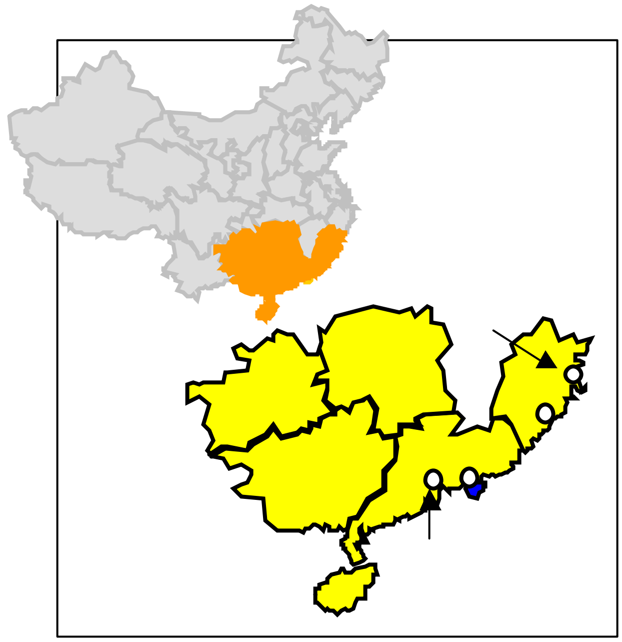


Table 10. Southern Population and Retail Sales Volume (2005-6)

	Total Population *(in millions)*		**Retail Sales** *(in billions)*	
	2005	2006	2005	2006
Guangdong	*91.94*	**93.04**	US$103.72 *RMB788.26*	US$119.97 *RMB911.80*
Fujian	*35.35*	**35.58**	US$30.87 *RMB234.58*	US$35.58 *RMB270.42*
Hunan	*63.26*	**63.42**	US$32.36 *RMB245.91*	US$37.29 *RMB283.42*
Guangxi	*46.60*	**47.19**	US$18.38 *RMB139.70*	US$21.06 *RMB160.08*
Hainan	*8.28*	**8.36**	US$3.53 *RMB26.86*	US$4.06 *RMB30.83*
Guizhou	*37.30*	**37.57**	US$7.99 *RMB60.69*	US$9.08 *RMB68.98*

Fueled by the emerging 'middle class' living primarily in capital cities and leading urban areas, Chinese consumer spending power is on the rise. With increasing disposable incomes, the capacity to buy higher value goods and services means U.S. producers need to take note of this significant market of the future.

Many of the global retail giants have already established firm footholds in the Guangzhou and Shenzhen markets. Having achieved early positive results, they, along with local retail chains, must now shift gears and target second and third tier cities throughout the south.

Table 11. Southern Market Disposable Incomes – Urban & Rural (2005-6)

	Disposable Income - **Urban**		*Net Income* - **Rural Residents**	
	2005	2006	2005	2006
Guangdong	*US$1,943* *RMB14,770*	US$2,107 *RMB16,016*	*US$617.10* *RMB4,690*	US$668.42 *RMB5,080*
Fujian	*US$1,621* *RMB12,321*	US$1,810 *RMB13,753*	*US$585.53* *RMB4,450*	US$636.18 *RMB4,835*
Hunan	*US$1,253* *RMB9,524*	US$1,382 *RMB10,505*	*US$410.26* *RMB3,118*	US$446.05 *RMB3,390*
Guangxi	*US$1,222* *RMB9,287*	US$1,303 *RMB9,899*	*US$328.29* *RMB2,495*	US$364.47 *RMB2,770*
Hainan	*US$1,069* *RMB8,124*	US$1,236 *RMB9,395*	*US$395.26* *RMB3,004*	US$428.42 *RMB3,256*
Guizhou	*US$1,078* *RMB8,195*	US$1,200 *RMB9,117*	*US$246.97* *RMB1,877*	US$261.18 *RMB1,985*

(Source: 2007 Guangdong Statistical Yearbook)

Rivalry is fierce, and retailers compete aggressively to win prime new shopping mall anchor tenant status. One interesting example is *Vanguard*'s *Mix-City* in Shenzhen. The site extends over 180,000 square meters and is zoned for a retail supermarket operation. However, to attract teens and young working adults with high disposable incomes, high-end fashion shops, fast food restaurants, a movie theater and ice-skating rink have also been added to the site. Along the same lines, several big shopping mall projects are being developed in neighboring cities such as Dongguan, Foshan, Zhuhai, Zhongshan, as well as other fast developing cities throughout the *Pearl River Delta*.

This growing trend of combining leisure and culture experiences with retail developments is fairly new, but gaining ground. Up and coming developments following this same trend include the *Metromall* in Nanhai; *Tour Mall* in Foshan, Dongfang Plaza, *Qixing Street* in Zhaoqin; new *Dehui Mall* in Shishi, Fujiang as well as *Wangguo Metropolis,* a one-stop shopping mall in Haikou, Hainan.

Another growing trend is in convenience chain stores following the early success of *'7-Eleven'* in South China. Franchise branded stores appear to dominate this developing sector of the market.

Specialty imported food retail stores are also becoming more prevalent. Examples include *Oliver Supermarket, Corner Deli,* and *Gourmet Fine Food Store* in Guangzhou. Retail wine shops specializing in imported wines are also on the rise. Two of the prominent importers of wine in the south are *Aussinot* and *Jointek.*

Table 12. The Pearl River Delta Economic Data

	2005	2006	Growth Rate
Permanent Population *(Millions)*	43.15	**44.47**	**3.1%**
Total Retail Sales	US$76.20 billion *(RMB579.60 billion)*	**US$87.9 billion** *(RMB668.20)*	**15.3%**
GDP	US$2,376.23 *(RMB18,059.38)*	**US$2,818.98** *(RMB21,424.28)*	**16.9%**

Source: 2007 Guangdong Statistical Yearbook

**The Pearl River Delta Economic Zone includes 13 cities and counties (districts), including Guangzhou, Shenzhen, Zhuhai, Foshan, Jiangmen, Dongguan, urban districts of Huizhou, Huidong County, Boluo County, urban districts of Zhaoqing, Gaoyao County- level City and Sihui County-level City. The data on banking refer to the sum of the nine cities in the Pearl River Delta, including Guangzhou, Shenzhen, Zhuhai, Foshan, Jiangmen, Dongguan, Zhongshan, Huizhou and Zhaoqing.*

Local retail management expertise is still in its infancy compared to international best practices. From product pricing strategies to promotion optimization, local retail management needs to better understand consumer demands and think in terms of providing solutions to win customer loyalty rather than short term cash generation.

Good examples are being set by Japanese and American retailers, and some local retail chains have recognized the importance of this customer-oriented approach to managing their operations, but they are the exception rather than the norm.

Mergers & Acquisitions

Recent M&A activities include *Wal-Mart* China Investment, purchasing 35% of *Trust-Mart*. Industry insiders believe this was a move to assist them in gaining access to the Guangzhou market where to date, they still have not been successful in gaining permission to open an outlet.

Cold Chain

Cold chain infrastructure development is also a major concern for retailers in the South. New distribution centers and modern expressways are better connecting ports with key markets throughout the South. This is now enabling more imported foods to be reliably distributed throughout the region effectively. However, while local importers and distributors are expanding operations, Hong Kong transshipments still play a significant role in food trade.

Other Significant Consumer Trends

Rapid urbanization and economic growth, particularly in the mainland's leading cities has provided a boon for local and international retailers. Local produce still dominants the market, however with the outbreak of SARS in 2003 and quite recently the H5N1 (bird flu) virus, consumers have concerns about food safety. The result has been an increasing demand for high-quality, well-respected imported food brands. In more affluent areas interest is growing for "green" and "organic" foods, but it remains a rather small niche market.

There has been an increasing demand for imported food items in the past five years. The most popular imports include baby foods/infant formula, chocolates, dried fruit and nuts, fresh fruit and vegetables, potato chips, popcorn and canned foods such as soup.

European and South East Asian exporters entered southern markets earlier than U.S. equivalents. In part this was due to the price sensitive nature of local consumers, but at the same time U.S. exporters were initially hesitant in building their brands. Today though, Washington apples, Sunkist oranges and California table grapes are commonly found in many supermarket shelves throughout the South as are durians and lychees from Thailand, butter from New Zealand and cheese originating from France and Australia.

While California wines are readily available, they need to compete with French, Italian, Australian, South African and Chile equivalents in this market.

Other fresh and packaged foods from the United States are also widely available today, however consumers lack the basic knowledge of how to prepare and serve them prompting most consumers to hesitate rather than buy. In response, the ATO in Guangzhou actively encourages U.S. produce exporters to register their products and provide labels in Chinese.

Table 13. 2006 Major Selected Hypermarkets/Supermarkets in South China (10,000yuan)

Retailer	Nationality *of* Ownership	Type	Sales Revenue	% Sales Growth	No. of Stores (China)	Expansion Rate %	No. of Stores (South China)	Key Mkts
CR Vanguard	Hong Kong	Supercenter Supermarket	3,785,344	**26**	2205*	11	200	Nation wide
Carrefour	France	Supercenter	2,480,000	**53**	108*	53	22	Nation wide
Wal-Mart	**U.S.**	Supercenter & Sam's Club	1,513,181	30	90*	27	25*	Nation wide
Trust-Mart	Taiwan	Supercenter	1,400,000	**6**	101	5	29	Nation wide
Metro	Germany	Warehouse membership	936,733	**24**	34	22	3	Nation wide
Park'N shop	Hong Kong	Supermarket	470,794	**13**	44	22	16	Guang-dong
Lotus	Thailand	Supermarket	1350,000	**34**	75	23	14	Nation wide
Minrun	Shenzhen	Supermarket	185,709	**27**	121	9	121	Guang-dong
Rainbow	Shenzhen	Supermarket	5,628,632	**32.25**	23	N/A	23	Guang-dong
A. Best	Shenzhen	Supercenter	1,425,490	**21**	99	25	99	Guang-dong
AEON Jusco	Japan	GMS	321,955	**23**	11	22	11	Guang-dong
Renrenle	Shenzhen	Supermarket	720,000	**7**	52	30	52	Guang-dong

Sources: Linkshop, CCFA & interviews by ATO Guangzhou

New Opportunities for U.S. Importing Foods into Southern China

Southern Chinese palates are opening to Western-style foods. As their purchasing power grows so does their willingness to buy such premium priced imported food items. Brand reputation and quality assurance are the key drivers as health and food safety concerns grow.

Promising U.S. food categories with little presence today include: cheese, beef, fresh fruits, baby food, nuts, natural fruit/vegetable juices, snack foods and ice-cream.

Popular U.S. imported items	**Main foreign competitors**
Oranges	New Zealand, South Africa
California Table Grapes	Chile
Washington Apples	Chile, N. Zealand
Red Meat (beef)	Australia
North West Cherries	New Zealand
Breakfast Cereal	U.K.
Frozen Potatoes	Canada, New Zealand
Dairy & Cheese	New Zealand, Australia, EU
Poultry (chicken wing)	Brazil, China
Nuts: (pistachio, almonds)	Iran
Wine	Australia, France, Italy, Spain
Fruit juice	France, Japan
Vegetable juicy	Japan
Alaska seafood (king crab, salmon)	Canada, Norway, Russia
Spaghetti Sauce	Italy, France, EU
Coffee	Japan, France, South Africa
Candy & Chocolate	Swiss, Italy, France, Belgium, Japan

Guangzhou Retail Market Update

Guangdong Province has the highest GDP at USD344 billion (RMB2,620 billion) of any single province in China, with retail sales valued at over USD120 billion (*RMB 911.8 billion*) in 2006, up 15.7% on 2005 figures. Driving Guangdong's economy is the Pearl River Delta (PRD). Guangzhou city sits at the apex of the PRD and its economic and political influence resonates throughout Guangdong and into neighboring provinces.

Major international retail operators that have set up their operations in Guangzhou include *Metro*, *Jusco* and *Carrefour*. Jusco *Teem He Plaza* store and *China Plaza store* took the early lead. *Jusco* is said to have recorded daily sales revenue as high as USD460,526 in one single store, with food accounting for 40 percent of this turnover.

Carrefour currently has four stores in Guangzhou and leads the imported food sector.

Land-O'- Lakes cheese display in GZ store

Metro initiated a fairly unique 'membership strategy' in the market: targeting small and medium-sized restaurants as well as families.

All three international retail operators have helped boost imported food items into Guangzhou targeting mostly high-end consumers in the region. The notable exception is *Wal-Mart* which has not been able to establish a Guangzhou outlet up to this point.

Hong Kong-based *Park'N shop with 44 stores* and Taiwan-based *Trust-Mart* with 100+ outlets both play important roles in the dynamic Guangzhou market. *Lotus* and *Homecity* supercenters are also lifting their presence. It is reported that food sales account for 40-50% of their total sales.

Smaller locally-operated supermarkets face stiff competition from these larger international players. Subsequently they have tried to adapt quickly to retain their market share, but have already lost considerable ground.

Convenience stores remain one of the most dynamic retail sectors in Guangzhou. Many have started to stock imported food items on their shelves as well as fast food counters to boost profits over lower-margin, daily need items. Store managers adjust product selection to fit each neighborhood. For example, they might stock fresh fruit and imported products in a store located near a five-star hotel; while a middle-class residential neighborhood store would stock more locally appealing products. Recent initiatives include fast-food and other value-added services such as phone card sales and subway card recharging service. *7-Eleven* has taken the lead in the South with more than 400 outlets concentrated in Guangzhou, Shenzhen and neighboring cities like Dongguan and Zhuhai. In 2004 *Dairy Farm* began a joint venture in Shenzhen and since then has opened 100 stores as a franchise operation in which they hold a 65% interest.

Taiwan-based *XiShiduo (C-Store)* has 72 convenience stores in the Guangzhou area. Most of them are located in up-market communities. Management have recognized the potential for stocking imported items and recently placed prominent point of sale displays promoting 'imported items' in 69 of its stores. Currently, imported items account for 5% of their total sales. Origins of imported products are marked with their national flags. The most popular imported items include candy, chocolate and cookies presented in gift packaging. Plans are underway to establish a branch office in Shenzhen and open more stores there along with the possibility of adopting a franchise management approach in the future.
Hong-Kong based *OK Liya (South China) Convenience Store Ltd.* was established in 2002, and operates 40 outlets. *OK* announced recently their goal is to open more than 500 new outlets in the next three years. About 80% of its sales were generated from the sale of food items, again primarily packaged candies and chocolate.

Other Major Southern China Retail Markets

Shenzhen is the second largest city in the PRD and is conveniently located at the main boarder crossing between Hong Kong and Guangdong. As far as retail is concerned, Shenzhen leads the market in terms of shopping mall quality, hypermarkets and modern retail supermarket penetration.

Enjoying a Special Economic Zoning status and easy access to Hong Kong and Macau, Shenzhen has attracted a large affluent migrant population from all over the mainland and abroad. It has also benefited from the recent Closer Economic Partnership Arrangement (CEPA) between Guangdong and HK SAR. CEPA has helped many trans-border operators move their products more freely *(some estimates say that around 50 percent of all food products imported into Hong Kong are immediately shipped to the mainland).*

Shenzhen is the headquarters for *Wal-Mart* in China and the same goes for *Jusco* and other large local operators such as *CR-Vanguard, Rainbow, A' Best and Renrenle*.

Retail market growth in the downtown area of Shenzhen has slowed recently as it nears the saturation point. However, ambitious plans are now underway to expand across the mainland. International retailers such as *Wal-Mart*, *Carrefour, Metro, Jusco* are now in a virtual race with HK based *Park'N Shop*, *CR Vanguard* and domestic operators to win market share in China's emerging markets as they quickly develop. Many have already set up stores in satellite cities around Shenzhen such as in **Longgangand Nanshan** *district*. Supermarkets continue to be the most common retail format, but hypermarkets are gaining in popularity and are now present in most medium and large-sized cities.

PRD cities experiencing the fastest growth include **Dongguang, Zhuhai, Zhongshan** and **Foshan.** Others that will likely follow suit include Zhanjiang, Shantou and Huiyang as they are seen as fast emerging markets.

In nearby provinces such as Fujian and Hunan, **Xiamen** and **Changsha** are also seen as attractive locations for retailers. In the near future, **Quanzhou, Zhangzhou, Jinjiang** in Fujian, and **Loudi, Yueyang** in Hunan are also recognized as high potential markets.

With this growth in mind many retailers such as *Wal-Mart, Carrefour and Jusco* have already established large purchasing centers in Shenzhen to support American, French and Japanese product standards and sales management principles into their southern China operations.

Regional supermarkets and hypermarkets purchase products from importers, wholesalers and distributors, because they face difficulties in obtaining and/or transporting such items into the mainland. Some lack the knowledge and resources to source imported foods and beverages, so many of them use agents in HK and ship products into Shenzhen or other regional distribution centers.

This demand allows importers and distributors to avoid paying VAT and customs duties that they would normally be exposed to in the HK retail market. This practice has created a "grey channel" that makes it difficult for U.S. exporters and most western-style supermarkets to source from, because they need proper invoices and health certificates before they can stock such products on their shelves. The ATO offices in China are encouraging U.S. companies to do their homework and develop direct trade relationships with buyers on the mainland to avoid this unofficial 'grey channel' and look more towards long-term relationships within the mainland.

Domestic competition is also rising. Local operators in Shenzhen include: *CR Vanguard, Rainbow, Park'N shop and A.Best as well as ShuiBao;* all likewise plan to open more stores throughout Guangdong to retain their market share. However, they still lag behind the larger foreign operators in terms of management expertise and capital strength.

Another trend in the South is the upgrading of traditional wet markets. Local authorities and consumers alike will likely continue to purchase daily food items from this traditional retail channel at least into the near future.

Profile of the key retailers

Retailers introduce imported food items to differentiate themselves from others and enhance the store image. Every so often, these retailers will launch 'in-store food festivals' and promotions to attract more traffic. Many U.S. imported food items are available on the shelves of the key retailers in South China. *Jusco, Metro and Sam's Club* are the best venues for U.S. imported products sales while other retailers carry fewer SKUs. Some branded items are selling well in these hypermarkets and supermarkets. Popular U.S. food items include Sunkist oranges, Washington apples, Northwest cherries, Alaska seafood, and U.S. poultry as well as various grocery items such as breakfast cereal, fruit/vegetable juices, spaghetti sauces, candy and wines etc.

Wal-Mart:

In-Store promotion food display in a Wal-Mart Shenzhen store

Wal-Mart continues to aggressively open new stores with the goal of penetrating into mainland second- and third-tier cities. Up to now, *Wal-Mart* has opened 90 stores in the mainland, 26 in the South alone. It is notable that *Wal-Mart* has now 13 stores in Shenzhen and five in neighboring cities such as Dongguan, Foshan, Shantou and Maomin, yet none in Guangzhou. It is estimated that several new stores will be opened in other second- and third-tier cities across Guangdong including Foshan, Huiyang, Shaoguan and Zhanjiang by year's end.

Wal-Mart's supercenter called Sam's club warehouse store has gained a good reputation in introducing imported food to local consumers. To date, three Sam's Clubs have been opened, including one in Shenzhen, one in Beijing, and another in Fuzhou. The Shenzhen store is reported to be one of the most profitable Sam's Club stores in the world.

Three supercenter stores have been opened in Xiamen, four in Fuzhou and one each in Jingjiang, Quanzhou and Zhangzhou respectively. The company's headquarters for the mainland is located in Shenzhen. Last year, the company celebrated its 10th anniversary in China.

To upgrade its supercenter stores' image, *Wal-Mart China* jointly held an American Food Festival in its 32 selected high-profile stores in 17 cities with the support of the ATO offices last summer. Later they reported sales of U.S. foods were valued at USD206,748 during the promotion. They also anticipate sales for U.S. food products will increase by 10% in the coming 12 months. *(For more details, please refer to GAIN report CH7602)*

Metro:
This German chain, regarded as the third largest retailing group in the world, opened its first cash-and-carry hypermarket in Guangzhou in January 2006. Today, they have 34 stores in the mainland and three in Guangdong including Guangzhou, Shenzhen and Xiamen and two new stores are planned for Quanzhou and Shenzhen. Imported food items in large package sizes could be found on the shelves. Metro is also well-known for its imported meat section. Wines from France, Italy, Australia, Chile and the United States are also available.

***Carrefour*:**
Carrefour's headquarters for southern China is located in Guangzhou. They claim their sales volume has increased by 25 percent from 2005 and expect the same for 2007. Today they have 103 stores in China, with 22 in the South. By the end of 2005, this French-based giant had 12 stores; in 2006 they opened anther 10 new ones in the cities of Shenzhen, Changsha, Foshan, Zhuhai and Xiamen. Stocking imported items such as fruits, snacks, biscuits, wines, gift packages, etc., but generally speaking they carry fewer SKUs compared with Jusco and Metro.

***AEON-Jusco*:**
Jusco is a key retailer in Southern China adopting a Japanese GMS (General Merchandise Store) merchandising approach. *AEON Jusco* stores have an excellent reputation locally for carrying high quality, imported foods.

Their target customers are mid-to-high income consumers. *Jusco* stores encourage a wide variety of food categories and also cater to the expatriate community in the Pearl River Delta. The management of these stores is also very eager to carry U.S. food and beverage products to meet the demands of their customers. Customer traffic in Shenzhen stores typically exceeds 20,000 shoppers per day.

U.S. fruit display in a Jusco store

Last year Jusco worked with the ATO Guangzhou office to hold an American Food Festival in its 11 supermarkets. It reported sales in excess of USD295,480 (over RMB2 million) during this the two-week promotion, up 30% from the previous year. They also expect sales of U.S. products will continue to increase in the coming year. *(For more details, please refer to GAIN report CH7614).*

***Trust-Mart*:**
With over 100 stores in mainland China and 29 in the south, Trust-Mart is one of the biggest retailers in the country. Trust-Mart recently sold a 35% stake in its China business to Wal-Mart. This Taiwanese company has 19 stores in Guangzhou, four in Shenzhen and one in Changsha, as well as others in the second-tier cities such as Dongguan and Zhanjiang.

CR Vanguard
As one of China's leading retail chain operators in China, this HK operator manages supermarkets, supercenters and superstores under the *Vanguard* brand name. In a recent interview, one of their managers stated he "foresees a new format in the future called their 'super center plus', which means a new format introducing more licensee shops inside the *CR Vanguard store*, aimed at aligning licensed shops to trade on their first floor where customers are more price-sensitive. Generally speaking, *Vanguard* targets customers likely to buy local produce; however increasingly, higher income shoppers are beginning to show interest in high-quality U.S. imported foods.

Vangurd's *Ole store* in Shenzhen has been successful in introducing imported foods such as cheeses, chocolates, coffee, wine, liquor, biscuits and fresh fruits at higher prices. Undermining this early success is an unstable supply chain and lack of promotion initiatives to support further demand growth.

Fujian Province & Xiamen

Fujian Province's retail market, including convenience stores, is also rapidly expanding. Fuzhou and Xiamen are the two key markets for imported foods. Quanzhou, Zhanzhou, and Jijiang are the emerging markets that most retailers have targeted including Wal-Mart, Carrefour and Metro. Carrefour was the first to open with two supermarkets on in Fuzhou city and the other in Xiamen.

Currently *Wal-Mart* has four supercenter stores in Fuzhou and three stores in Xiamen. All carry imported food items. It has been said that Xiamen's *Wal-Mart store* recorded the 3rd highest turnover in a day (USD789,470 with only a 12,000 square meter layout). *Wal-Mart* plans to open two more stores in Xiamen by year's end.

While today there are only 150 convenience stores in Xiamen, industry analysts believe it has the capacity for one convenience store per every 3,000 inhabitants; that equates to a potential of 400 stores to satisfy the population of 1.2 million. *Beatrice* is locally regarded as the leading operator in this retail sector and is headquartered in Xiamen. Opening its first store in 1997, the company now has 27 local stores. They also recently opened *Beatrice* stores in Suzhou (70), Chengdu (2) and Guangzhou (15 – but these are franchises rather than company-owned and operated).

Stores in each city only purchase what they believe best meets local demand. *Beatrice* normally sources their imported items from brokers. Before 2003, all *Beatrice* stores' individually covered 200-300 square meters. Originally, the stores carried fresh fruits, but management discovered customers preferred to source them from local wet-markets. The most popular items they sell include instant breakfast, salty biscuits, nuts, preserved plums, candy, and juices. In their newest stores, U.S. imported food items are available including frozen chicken, almonds and pistachios. After *Wal-Mart, Carrefour* and *Metro* entered Xiamen, *Beatrice* adjusted their business focus and today open smaller operations typically in the 80-100 square meter floor space range and typically located near hotels and restaurants and in higher income neighborhoods.

In comparison, *7-11* stores (with no presence in Xiamen) typically cover 30-50 sq. meters. Eighty percent of *Beatrice* products are food items and the remainder tend to be daily household consumer items. *Beatrice* targets young working adults (18-40 years) with higher disposable incomes. Popular food items include fresh baked bread, sweet corn and preserved eggs.

General Market Entry Tips

It is important to conduct taste tests locally to gauge the market's response to new flavors and packaging design before launch. Leveraging strong distributors as your key channel is crucial for U.S. exporters. This approach would ideally involve the following steps:

1. Market research analysis to identify key markets (which cities and which retail outlets best reflect your product's target customers).
2. Capability to negotiate with ideal retailers and gain best shelf placement
3. Point of sale displays that attract target customers
4. In-store promotions to raise awareness and encourage taste testing with trial offers as the early adoption phase in building your brand.

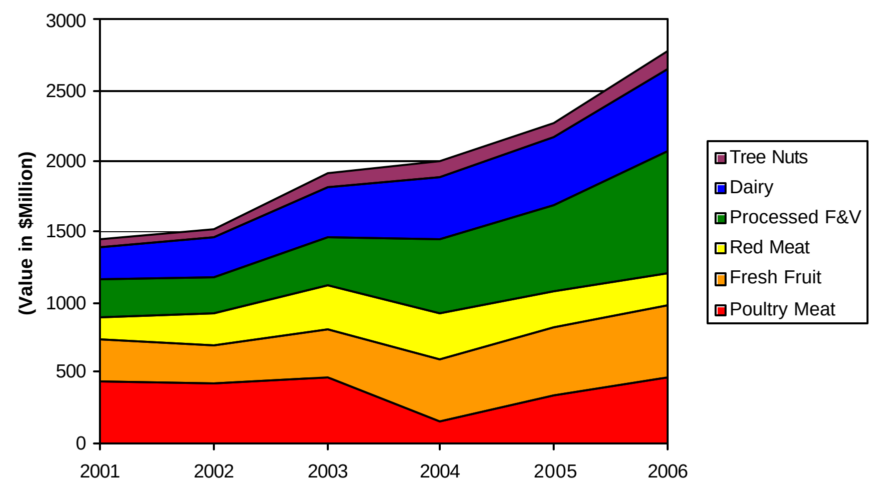
In-store food demonstration and fc tasting

To best manage this process, a realistic marketing plan needs to be prepared reflecting the important steps identified above to ensure early and longer term success.

III. Competition

The most serious competition for U.S. food exporters comes from local and joint venture food producers and processors. The quality of fruit and vegetables in particular has increased rapidly, and many local traders now contend that the best of China's fruit is similar in quality to imports. The general lack of coherent marketing systems continues to plague China's industry, however, making it difficult to source significant quantities of products with consistent quality. While oranges similar in quality to U.S. navel oranges are available, the transaction costs of dealing with large numbers of small farmers, then sorting and packing raises the final market price to levels similar to imports. The formation of farmers' voluntary organizations such as the Zhejiang Pear Association has the potential to reduce these problems, but such organizations are still relatively new.

Figure 11: Imports of Selected High-Value Products, All Sources, 2001-2006



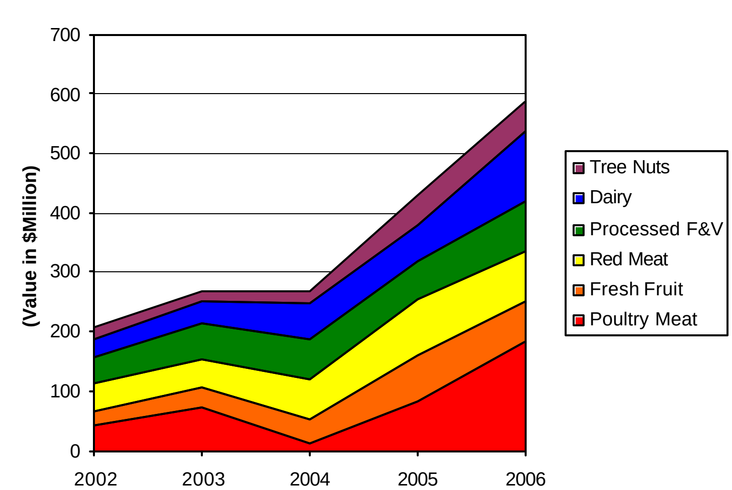
Source: Global Trade Atlas 2007

Competition is equally intense for processed foods, although differences in taste mean that the primary competition comes from third country competitors or joint venture manufacturers. Shelves may appear to be stocked with famous foreign brands such as Kraft, Lays and M&Ms, but close inspection reveals that most of these products are manufactured locally or in Southeast Asia. This allows manufacturers to cash in on brand identification, take advantage of low labor costs in China, and adapt their products to Chinese tastes and labeling regulations, all at the same time. Years of food adulteration scandals have made Chinese consumers cynical, however, and most will attribute a higher level of quality safeguards to food products that are genuinely imported.

The general trend to date has been for local manufacturers to push imports out of the price-driven mass market and into niche markets where quality and novelty are more important than price. This has already happened to varying degrees with pet food (Mars' locally manufactured Pedrigree and Whiskas labels dominate the middle market), wine (Chinese labels dominate at the low end), apples (Washington State apples sell extremely well in gift markets) and confectionery (Mars). Growing local competition has emerged for table grapes, and domestic sweet cherries, lemons and almonds appear to be improving in both volume and quality, albeit from a very low base. Certain products, particularly western-style prepared foods, face little or no competition from local manufacturers, constituting a niche unto themselves. Improvements in quality and increased efforts at brand development are allowing Chinese companies to compete more effectively for some niche markets, but local manufacturers face the same distribution problems as imported products, as well as a high level of skepticism among consumers.

Third country competition comes in two distinct areas: commodity-type products such as frozen meat, poultry, seafood and fresh fruit, and western-style niche products such as canned and prepared foods and ethnic cuisines and ingredients.

Figure 12: Imports of Selected Products from the U.S., 2002-2006



Source: USDA - BICO Commodity Aggregations

Competition in the fresh and frozen meat, fruit and vegetables arena, as well as dairy, comes primarily from Pacific rim neighbors, including Thailand, New Zealand, Australia, Canada and Chile, as well as South Africa and Brazil. Competition for western-style prepared foods is much more global, with competitors playing to their strengths in individual products such as olive oil, wine, pasta and pasta sauces.

The U.S. remains the largest single exporter of consumer-oriented food to China, with a 20% share of China's total imports in 2006, and is the only exporter with a presence in most categories. China is attracting a growing level of interest from other countries, however, and has signed or is negotiating bilateral trade pacts with many of its neighbors. The following is a brief outline of key products and competitors.

Top Products and Competitors	
Oranges	New Zealand, South Africa
Grapes	Chile
Apples	Chile, New Zealand
Cherries	New Zealand
Lemons and Limes	New Zealand
Red Meat (f/c/f)	Canada, Denmark, New Zealand, Australia *Currently beef and related products from the U.S. are not allowed in China*
Breakfast Cereal	United Kingdom, Australia, Korea
Cheese	New Zealand, Australia, EU
Frozen Processed Products	Canada, New Zealand
Frozen Corn	Australia, EU
Dairy (not incl. cheese)	New Zealand, Australia, France
Poultry	Brazil
Tree Nuts	Russia, Korea (chestnuts), Iran (pistachios), Mongolia
Premium Chocolate	Switzerland, Belgium, Italy, France
Premium Ice Cream	France, New Zealand
Seafood	Russia, North Korea, Canada, Norway, Japan
Wine	Chile, France, Australia, Italy
Ginseng	Canada, Korea

IV. Best Product Prospects

IV.A Products Present in the Market Which Have Good Sales Potential

- Nuts and dried fruit (prunes, raisins)
- Seafood
- Poultry meat
- Red meat (U.S. beef and related products are currently not permitted entry into China)
- Frozen vegetables (esp. sweet corn)
- Infant formula
- Baby food
- Dairy products (cheese and butter)
- Baking ingredients and bread bases
- Frozen potato products
- Fresh fruit (oranges, apples)
- Premium ice cream

IV.B Products Not Present in Significant Quantities, Which Have Good Sales Potential

- Fresh fruit (cherries, pears)
- Processed/dried fruit (blueberries, cranberries)
- Mexican, Indian food
- Ready-to-cook and ready-to-eat foods
- Organic foods (niche market)
- Functional foods

V. Post Contact and Additional Resources

FAS has five offices in China:

Agricultural Affairs Office, Beijing
5-2 Qijiayuan Diplomatic Compound
Jianguomenwai, Beijing, 100600
Phone: (8610) 6532-1953
Fax: (8610) 6532-2962
E-mail: agbeijing@usda.gov

Agricultural Trade Office, Beijing
Kerry Center, Beijing
24th. Floor, Suite #2425
Phone: (8610) 8529-6418
Fax: (8610) 8529-66922
E-mail: atobeijing@usda.gov

Agricultural Trade Office, Guangzhou
China Hotel Office Tower, 14/F
Guangzhou 510015, China
Phone: (8620) 8667-7553
Fax: (8620) 8666-0703
E-mail: atoguangzhou@usda.gov

Agricultural Trade Office, Shanghai
Shanghai Center, Suite 331
1376 Nanjing West Road
Shanghai 20040, China
Phone: (8621) 6279-8622
Fax: (8621) 6279-8336
E-mail: atoshanghai@usda.gov

Agricultural Trade Office, Chengdu
US Consulate General, Chengdu
Agriculture Office
4 Lingshiguan Lu
Chengdu, Sichuan, PRC 610041
Phone: (86) 1380-821-2410
Fax: (8628) 8513-8698
E-mail: atochengdu@usda.gov

VI. Other Relevant Reports:

Business Etiquette Report GAIN Report #CH4835

Emerging City Markets

- Hangzhou GAIN Report #CH7819
- Suzhou GAIN Report #CH7816
- Wenzhou GAIN Report #CH7814
- Tianjin GAIN Report #CH7417
- Emerging City Markets: The Next Economic Miracle GAIN Report #CH7403

Jusco In-Store Promotion Evaluation Report 2007 GAIN Report #CH7614

Market Development Report

- Qingdao #CH6414
- Harbin #CH6406

Wal-Mart Great American Food In-Store Promotion 2006 GAIN Report #CH7602 (referenced page 39)