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Taiwan

Coffee

Coffee Retail Market

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Report Highlights:

Taiwan is the 8th largest importer of U.S. coffee in the world. Canada alone represents a 50% share of U.S. exported coffee, followed by Germany and Japan. However, Taiwan imports of U.S. coffee may be on a downward trend. In 2006 the United States represented less than 2% of Taiwan's imported coffee market. Indonesia and Vietnam imports constitute more than 50% of Taiwan's imported coffee, with U.S. coffee ranked 14th in terms of market share. Taiwanese love for coffee continues to grow and is marketed in various forms from posh cafes to convenience store sales of canned, flavored ice coffee.

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I. MARKET OVERVIEW

A. Service Economy

For many years, manufacturing has been the primary engine of economic growth in Taiwan. However, with the rise of the knowledge economy and increasing income levels, the focus of growth in Taiwan's economy has shifted from manufacturing to services. Today, Taiwan is a service-based economy. This means Taiwan is on footing similar to the United States, Germany, Japan and other developed nations. Health and entrepreneurial spirit play a large role in service sector development, so relevant government agencies and organizations will hopefully step up progress in loosening overly restrictive regulations and encourage measures targeting sector promotion. Taiwan hopes to see its service sector become a powerful engine for growth in the national economy.

The franchise industry is a key part of Taiwan's service sector. This helps single-owner retail operations be competitive as part of a larger organization. Franchised operations have helped Taiwan's development and still have good growth prospects in the future.

B. Domestic Coffee Production

There are several theories of how coffee arrived in Taiwan, one of which is that British merchants brought it from Manila in the 19th century. Another theory claims that the Japanese brought it in the 20th century. In any case, Taiwan has produced coffee locally for many generations. Taiwan's subtropical climate and mountainous areas are similar to most coffee-growing countries. Production declined dramatically in the mid-20th century because of World War II, during which many farmers returned to rice planting.

Currently, the four primary locations of domestic production are Huisun Forest Farm (Nantou), Hepao Mountain (Kukeng, Yunlin), Tungshan and private Tainan farms. Taiwan coffee farms are small and thus unable to supply the island-wide consumer base. Many coffee growing regions are trying to carve out niches in the domestic coffee market. An example of this is at Kukeng where, traditionally known for growing oolong tea, coffee is being cultivated again. Kukeng hosts an annual Taiwan Coffee Festival at which international tasters judge locally produced coffee beans and coffee free pourers and bean roasters compete. This has helped stimulate Kukeng's economy and may lead to revitalization of coffee cultivation.

C. U.S. Coffee Imports

Taiwan is the 8th largest importer of U.S. coffee in the world. However, Canada alone represents a 50% share of U.S. exported coffee, followed by Germany and Japan. Furthermore, Taiwan imports of U.S. coffee may be on a downward trend. In 2006, U.S. roasted coffee represented less than 2% of Taiwan's imported coffee market. Indonesia and Vietnam imports constitute more than 50% of Taiwan's imported coffee, with U.S. ranked 14th in terms of market share.

II. COFFEE RETAIL SECTOR

In 2006, cafés/bars valued at a little over US\$657.9 million and the number of units/outlets decreased by 3% because of a decline in specialist coffee shops units/outlets. Euromonitor expects annual growth of 4% reaching US\$789.5 million by 2011.

The importance of the retail sector to the overall economy continues to increase. In facing future economic changes and challenges, retailers will play a critical role. Also, as the retail sector must address a myriad of consumer demands, it is, by necessity, the most flexible and responsive of all sectors of the service economy. As a result, retailers are the essential facilitator between manufacturers and consumers. Also, the broad scope of retailing means that, in addition to manufacturers, retailers are heavily involved with other sectors, including areas of communications and publicity, in order to spur sales and business growth. Retailers also stimulate downstream sectors such as art/culture and leisure/tourism. The retail sector bears a significant responsibility to meet and satisfy the demands of the general public.

The government has laid out a 3-stage, 9-year plan that defines an economic development vision for the year 2015 that promises a more vigorous and competitive investment environment for Taiwan and assists domestic retailers to overcome international competitive pressures and establish the foundations for healthy and sustainable growth.

A. Trends

i. Consumer Trends

The relatively high standard of living in Taiwan has led to high expectations from cafés. A comfortable environment conducive for socializing and reading is a minimum requirement. But now with the proliferation of wireless internet in major Taiwan cities, wireless internet access is also in high demand at cafés. In-shop music, product design and packaging are all becoming increasingly important as means of attracting customer business in an increasingly competitive market. Value-adding market strategies are beginning to draw more revenue than actual retail coffee (these include cakes, snacks and other food and beverages).

In regards to the take-out sector of the market, customer demand for convenience is crucial. The location of the store plays a critical role in its success. Different means of paying for coffee, such as electronic money cards, have been introduced to reduce waiting time. Several procedural adjustments behind and in front of the counter have been initiated to meet consumer demands for speed.

In recent years, Taiwan's cost of living surpassed personal income of Taiwan consumers, being a key reason for slower growth in value sales. Another reason is that many Taiwan citizens have taken jobs in mainland China, so the consumer base has shrunk.

ii. Retail Store Trends

Chain cafés/bars had better sales growth in 2006 than in 2005, but did not perform as well as they did in 2004. This is because the expansion in number of outlets in 2005 led to further saturation. This saturation of chain stores has caused many operators to begin exploring the option of expanding into southern Taiwan.

The largest portion of sales of cafés/bars remains drinks, accounting for 80% of value in 2006. However, as cafés/bars begin to offer larger variety of food products, the sales value of food has steadily increased.

Prior to 2005, the sales share gap between chain cafés/bars and independent cafés/bars was in favor of independent cafés/bars. In 2005, this gap switched and was in favor of chain cafés/bars and has grown to the point that chain cafés/bars have nearly 63% of the market and independent cafés/bars just over 37%.

Cafés/Bars by Subsector: Units/Outlets 2001-2006 (Number of Outlets)						
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Cafés/bars	2,115	2,174	2,128	2,327	2,370	2,302
- Chain cafés/bars	701	750	890	1,149	1,306	1,300
- Independent cafés/bars	1,414	1,424	1,238	1,178	1,064	1,002
Specialty coffee shops	961	1,096	1,350	1,655	1,679	1,571

Source: Euromonitor International: Country Sector Briefing, *Cafés/Bars - Taiwan* (April 2008)

Take-away sales have increased as cafés/bars target office workers. Take-away has now become a major part of revenue, totaling around 30% of sales in 2006.

B. Competition (Recent Endeavors)

i. Brief Survey of Major Competing Companies

Comestibles Master Co., Ltd.

Comestibles Master Co., Ltd. had the greatest increase in market share of cafés/bars in 2006. With the massive expansion of 85°C Café outlets, the company replaced President Coffee Corp. (Starbucks) as having the highest, total-sales volume. Comestibles Master intends to continue increasing its number of outlets, thus also increasing its sales. On average, every 85°C Café outlet serves 600 customers a day, each customer spending on average US\$3.29. A special feature of 85°C Cafés is their outlet design allowing for customers to see the preparation process of all bakery items. Their aggressive pricing is putting pressure on both coffee shops and traditional western-style bakeries.

Barista Coffee Inc.

Barista Coffee introduced new products like coffee with Kahlua, coffee wine and coffee with syrup extracted from nuts. Barista Coffee focused on forming working relationships with travel agencies and banks as a means to increase its consumer base.

President Coffee Corp.

President Coffee (Starbucks) began promoting a new line of soy-based drinks. These included Soy Lattes, Soy Mochas, Soy Macchiatos and Cinnamon Soy Mochas in Starbucks outlets.

Name	Food	Established	# of Outlets	Area in Taiwan
eCoffee	Coffee	2002	235	North, Central, South, Peng hu, Jing men
Starbucks	Coffee, pastries	1998	190	Island-wide
Dante Cafe	Coffee, pastries	1993	124	Island-wide
3 Royalty 3 House	Coffee, meals	1994	50	North, Central, South
Ikari	Coffee	1994	50	North
Barista Coffee	Coffee	1997	34	Island-wide
Rose House	Coffee, meals	1990	33	North, Central, South
Mr. Brown	Coffee	1998	21	North, Central
Brunch Caffè Italiano	Coffee, meals	1998	17	Central, South
McCafe	Coffee	1984	14	Island-wide

Source: Taiwan Chain Store Almanac 2007, p. 149-150

ii. Competitive Changes

Continued market growth has encouraged fierce competition within a retail sector with over 1,000 outlets from various corporate competitors. There is clearly a maturing demand for coffee among Taiwan consumers. On the high-end premium side of the market, there is steady growth but among a smaller number of corporate competitors with several businesses shifting to other retail items. On the low-priced side of the market, new franchises and coffee chains are entering the market, capturing market shares of traditional low-end coffee chains.

Chain coffee retailers are moving toward differentiation, allowing different chains to portray distinct characteristics. From emphasizing their high-quality cakes to offering full meals, differentiation is a goal worth pursuing in a saturating market. Other options chain coffee retailers are exploring corporate alliances to extend brand names beyond the outlets. For example, Starbucks, Barista and Zhenguo Café have all begun producing retail-packaged coffee beverage items sold in convenience stores and supermarket chains. Offering seasonal gift boxes, coffee-flavored egg crisps, chilled jelly cakes, moon cakes and a variety of innovative products are being used to increase brand exposure as well as opening new business arenas of opportunity.

Domestic companies have fared well against multinational companies. In order to compete with multinational companies, they have oftentimes opened flagship outlets with more space and value added services. It seems that domestic companies believe that increasing the number of outlets will result in an increase of market share.

An interesting ingredient to the retail sector is the growing number of non-traditional corporate competitors. Increasing domestic demand for coffee has encouraged other corporations to begin offering freshly brewed coffee. Thus, fresh coffee is no longer only found in coffee shops, but places such as McDonalds and convenience stores. McDonald has opened a series of McCafés and Uni-President's 7-11 convenience store chain now sells fresh coffee using the City Café brand name.

C. Marketing Strategies

Offering quality products has already become a *minimal* competitive requirement. Thus, companies should continue to differentiate their brands from other competitors to ensure that customers have a unique experience and that this differentiation will attract a wide range of consumer groups.

Quality of frontline service staff is also important because it strongly influences ultimate customer satisfaction and is a large factor in attracting customers to return. Staff must have proper training and chains should provide incentives to encourage baristas and staff to be warm and courteous. Another means of pleasing customers is to establish familiar relationship with customers who frequent the store.

The three major expenses in the retail coffee business are human resources, contractual lease agreements and product costs. Salary scales should be streamlined and the ratio between permanent and contract employees adjusted to maximize productivity. High-quality products and professional management should be developed. Space utilization is also important to raise profitability.

D. Future Prospects

Cafés/bars sales growth is expected to increase as consumers learn more about coffee and associated products. Likewise, the number of cafés/bars outlets is expected to increase as companies begin to expand into Southern Taiwan. However, this expansion is not expected to be very rapid because only the larger players with a strong consumer base are considering developing outside Taipei.

Raw material prices are expected to increase in line with the current trends. Seasonal promotions accompanied with new products (such as cakes and sandwiches) to go with coffee are common ways to add to sales value and also encourage coffee culture in local communities.

Comparing Chain and Independent Cafés/bars Pros and Cons

	Chain Cafés/bars	Independent Cafés/bars
Market Saturation	Chain cafés/bars, as they tend to be the larger competitors, are at an advantage in a saturated market. Larger competitors will try to increase their market share by opening more outlets and increasing menu items to meet consumer needs.	Independent cafés/bars, usually smaller competitors, will be at a disadvantage as the market becomes more and more saturated.
Increased Cost of Raw Materials	Because of the rising cost of raw materials, prices in cafés/bars are expected to increase. Chain cafés/bars may be at a disadvantage because of shared products. This will be especially disadvantageous for franchise stores because of their need to follow headquarter regulations and use products and materials in their contracts. Thus, if their headquarters announce a price increase of products or materials, all franchise stores must do the same.	In general, prices in independent cafés/bars may increase, but they have an advantage because they have a flexible pricing strategy unlike chain and franchise cafés/bars. Thus independent cafés/bars operators may choose to use cheaper ingredients or change the ingredients used in their products.

New cafés/bars brands are expected to perform well. A good example of this would be McCafé from McDonald's Restaurant (Taiwan) Co., Ltd. which has done well thus far and is considering increasing the number of outlets and evolving into a 24 hour café to boost market share.

III. READY-TO-DRINK (RTD) COFFEE SECTOR

In 2007, the off-trade RTD coffee in Taiwan valued approximately US\$390 million and the average unit price increased by 2% to US\$2.94. Growth prospects are at a steady 4% and likely to reach US\$480 million by the end of 2009 according to Euromonitor.

A. Major Distribution Channels

Taiwan has the world's highest convenience store density. Thus a majority of RTD coffee products are sold in several convenience store chains island-wide. Large competitors in the convenience store sector include 7-11, Family Mart, Hi-Life, OK and Niko-Mart. The volume share of RTD coffee sold through these stores continues to grow with good future prospects. Another main channel for sales is through online cafés, catering to those who need to stay up late at night. However, price growth for RTD coffee sold through online cafés is small because of aggressive competition.

B. Trends

Production costs have increased due to price increases of raw commodities such as cream, milk and coffee. Despite the negative effect this has had on profits, the industry still showed strong performance in RTD coffee sales sold through the massive off-trade convenience store sector. On the other hand, on-trade RTD coffee sales have been hindered by the sheer number of cafés and the fact that most coffee drinkers prefer freshly brewed coffee. This most of this report was written before the melamine scare in Taiwan, so this will also have a negative impact on both fresh and RTD coffee sales during the fall of 2008.

There has been increasing demand for RTD coffee because of branding, new products and marketing campaigns that have all contributed to a growing consumer base. Unit value increase surpassed volume growth because of a consumer preference for high-quality products. These preferences include coffee from Arabica coffee beans and fresh milk.

Off-trade Sales of RTD Coffee: Volume 2002-2007 (Million Gallons)

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
RTD Coffee	32.0	33.0	34.0	34.6	35.3	36.1

Source: Euromonitor International: Country Sector Briefing, *Rtd Coffee - Taiwan* (April 2008)

Off-trade Sales of RTD Coffee: Value 2002-2007 (\$US Million)

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
RTD Coffee	313.8	325.7	339.6	355.2	373.0	390.9

Source: Euromonitor International: Country Sector Briefing, *Rtd Coffee - Taiwan* (April 2008)

Metal cans are the common packaging for RTD coffee in Taiwan. Taiwan consumers judge RTD coffee value by its packaging, and so manufacturers aim for two goals: 1) increase packaging attractiveness and 2) increase price. Companies look for different options such as cartons and PET bottles. Cartons appear to be the up and coming trend because it is the preferred packaging by convenience stores.

C. Competition (Recent Endeavors)

King Car Food Industrial Co., Ltd.

King Car carries the brand Mr. Brown. It had 39% of the RTD market, the largest in 2007. King Car's share is expected to grow as it launches new brands such as Café Lounge and Platinum, which has begun exploring more premium RTD coffee for value growth.

Wei Chuan Foods Corp.

Wei Chuan carries the Wei Chuan Bernachon brand. This brand was introduced in 2004 and is expected to grow because of its distribution network in chilled RTD coffee. Wei Chuan has also aggressively pursued branding. In 2004, Wei Chuan Bernachon was the first brand to use plastic packaging for its RTD coffee, which was a resounding success.

Mr. Brown Coffee Shop

Mr. Brown Coffee Shop was launched in mid-2006, an extension of the original Mr. Brown brand. This has been made available in 330ml PET bottles.

Hey-Song Corp

Hey-Song Corp launched its Black series of Hey-Song WIN American Coffee. The targeted consumers were those who needed to stay awake. Unlike most RTD coffee brands that

feature a distinctly European style, Hey-Song used an American design. The company utilized the slogan "less sleeping hours = more time for entertainment" in 2005 to pitch the brand to younger coffee drinkers. In 2006, the Black series claim of strong caffeine did well.

D. Future Prospects

Transition from Freshly Brewed to RTD

It is questionable whether or not this transition will be successful. Currently, Starbucks exploring this option and has begun investing in promoting its RTD products, taking the spotlight away from its freshly brewed coffee. If Starbucks is successful in this endeavor, it may encourage other brands to begin marketing RTD coffee.

Volume Growth Steady

RTD sales volume is not expected to increase significantly. The coffee boom in the late 1990s has faded and so the coffee consumer base is not expected to grow rapidly. Furthermore, RTD coffee always faces fierce competition from cafés.

Strong Value Growth

As the coffee culture in Taiwan grew, starting in the 1900s, the Taiwan coffee consumer base also grew in its appreciation of coffee. Because of this growing appreciation, coffee consumers are expected to increasingly purchase branded coffee products. This will lead to increased unit prices.

New Niches

Several niches can be carved out. A recent example in RTD coffee is gender-targeted brands. Wei-Chuan's Wei Chuan Bernachon is targeted at men and Uni-President's La Gauche De La Seine at women. European and South American coffee flavors are also beginning to gain momentum as coffee drinkers look for new tastes. King Car targets office workers with its premium Mr. Brown Coffee Shop products and several other companies are following suite. Other possible niches to explore would be healthy ingredients in RTD coffee because Taiwan consumers are health conscious.

IV. Post Contact and Further Information

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