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## China, Peoples Republic of

### Agricultural Situation

### Chengdu: Untapped Emerging City Market

### 2008

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**Report Highlights:**

The city of Chengdu, the capital of Sichuan province, is one of the most prosperous and affluent cities in China's interior. The residents of Chengdu have a passion for food and are very receptive to U.S. foods and food ingredients. Rising incomes are creating significant opportunities for U.S. exports in Chengdu's hotel, restaurant, and institutional (HRI) and retail sectors. Lower import saturation offers first-to-market opportunities to those who overcome logistical barriers.

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**I. Market summary:**

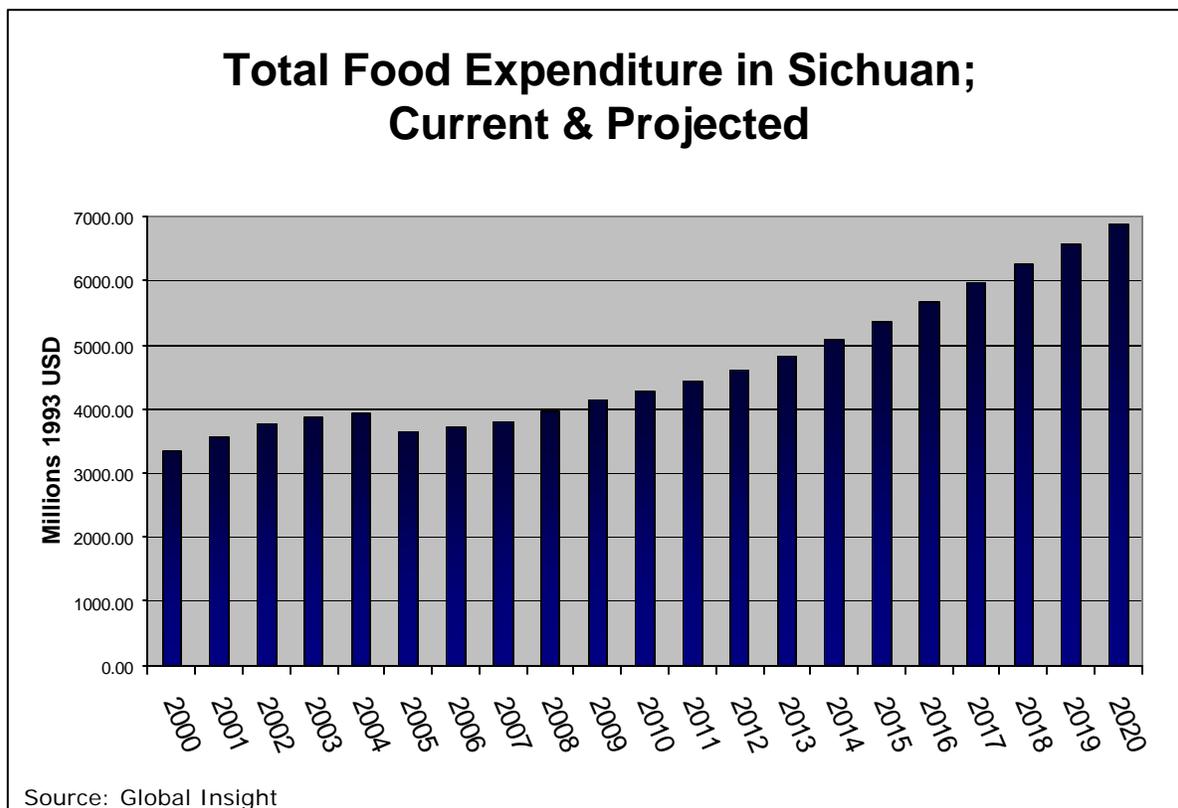
**Chengdu: An Emerging City Market Ripe for Development**

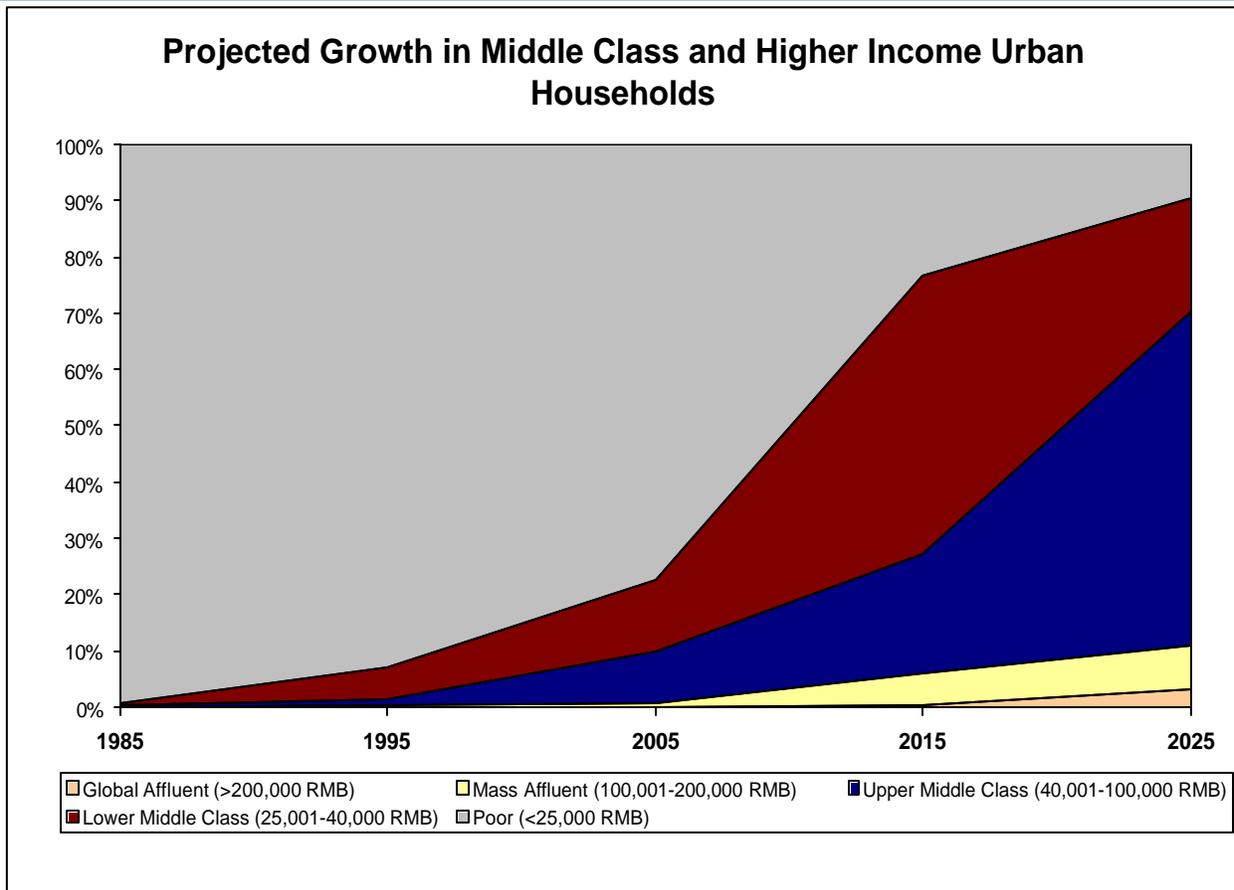
Chengdu, the capital and cultural center of Sichuan province, is a prime target for U.S. agricultural exports as an emerging city market in China’s heartland. It is the wealthiest and most advanced city in Southwestern China. Even though Chengdu accounts for only 12 percent of Sichuan’s population, it made up 32 percent of the province’s GDP in 2007. Its prosperity, high standard of living, and quality of life has given the city a reputation of being an easy place to move to, but a hard place to leave. This rapidly-expanding market offers exporters a market with double-digit growth rates, increasing demand for imports, less market saturation than the major coastal city markets, and a passion for food.



**Rapid Current, Projected Growth Rates Indicate Growing Market for U.S. Agricultural Exports**

The economic growth the region is experiencing is raising incomes and increasing the market for foreign products. Chengdu’s gross domestic product increased by nearly 17 percent in 2007, while its per capita disposable income grew by 16 percent in the same year. The rapid economic development is fueling increased expenditure on food and beverage sales. Global Insight estimates that in real terms, total food consumption in Sichuan province has increased nearly 14 percent from 2000 to 2007. This trend is expected to continue, as Sichuan’s food expenditure is projected to increase 82 percent from 2007 to 2020.

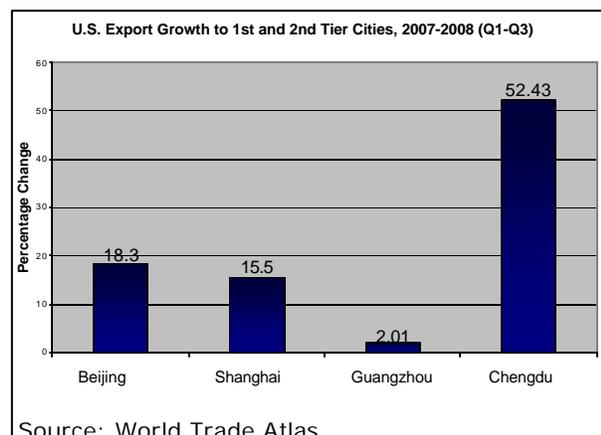




By serving urban working households today, particularly those in second- and third-tier cities, exporters gain exposure and experience necessary to stay relevant as the middle class grows and consumer tastes evolve. A.T. Kearney estimates that 75 percent of the middle market in China will be in second-tier and third-tier cities by 2017. McKinsey approximates that middle-income consumers now represent almost 35 percent of urban population, and at current growth rates will exceed 50 percent by 2010 and 70 percent of the total population by 2015. McKinsey also projects that urban food consumption will increase nearly fourfold from 2004-2025, an increase in value of \$427 billion China-wide.

### Less Market Saturation Means Less Competition, Marketing Dollars Go Further

As an interior emerging city market, Chengdu's market has less import penetration than developed port cities. This provides several advantages to marketing products in Chengdu and other emerging city markets. New imports face less foreign competition than in the developed port cities, despite burgeoning demand. This first-to-market advantage means that marketing dollars go further, as it is less costly to build a market share without competition and maintain it than to try to



break into one of the mature city markets, like Beijing, Guangzhou, or Shanghai.

### A Burning Hunger: Significance of Food in Sichuan

Sichuan is also known for its passion for food. Consumers are keen to try imported products and are willing to pay a premium for a quality product. Chengdu's residents allocate the highest per capita expenditure in China on food away from home. As incomes have increased and tastes have been influenced by Western food culture, consumers are increasingly attentive to food safety and food nutrition. There has been an increase in foreign food establishments in Chengdu.

The people of Chengdu have the propensity to try new foods and incorporate them into their own cuisine. A "new Sichuan cuisine" has evolved from traditional Sichuan cuisine in recent years. The new cuisine puts increased emphasis on food nutrition and the inclusion of non-traditional and imported ingredients. This has been a boon to western-style inputs, like dairy products, and imports, including imported meats and seafood. As one of the most well-known styles of Chinese cooking, Sichuan food plays a leadership role in food trends. It is held in high esteem across China and influences both the national market and other regional markets.

Chengdu at a Glance (2007 figures)	
Province	Sichuan
Population	11,000,670
Gross Domestic Product (GDP)	\$48.9 billion
GDP per capita	\$3,634
Per capita disposable income	\$2,000
Growth in per capita disposable income	15.7%
Primary industry	\$23.6 billion
Secondary industry	\$150.4 billion
Tertiary industry	\$158.5 billion

Source: www.chengdu.gov.cn

### A Center for Business and Travel in the Southwest

Tourism and foreign investment have led to increased interest in foreign food cultures and imported products. Chengdu is an attractive business development center. It has been designated as a target economic development zone by the national government. More than 125 of the Fortune 500 companies have established offices or invested in Chengdu. This business presence has driven increased demand for conferences, business meetings and other events.

Chengdu serves as a jumping-off point for tourism attractions in Sichuan province, Tibet, and other destinations in the Southwest. In 2006, Tourism in Sichuan was valued at \$470. The May 12, 2008 earthquake that rocked the province significantly hurt tourism revenues, but industry is finally starting to recover. This combination of tourism, business, and tradition of dining out has set the stage for annual expenditure of billions of RMB on lunches, dinners and banquets.



Chunxi Road Shopping District

### Planes, Trains, and Automobiles: Current Infrastructure and Future Development

Transportation infrastructure is rapidly developing in Chengdu, making the way for increased imports. In 2006, the Chengdu Shuangliu International Airport was ranked sixth in China for passenger and freight turnover, and its freight turnover increased by 17.7 percent (www.investchengdu.gov.cn).

Chengdu is an important rail hub in Southwestern China. Ports of entry and exit for rail transportation to and from Chengdu for imports and exports include Shanghai, Shenzhen, Tianjing, Nanjing, Qingdao, and Lianyungang. The railway station can currently handle 100,000 containers per year. The Chengdu Railway Container Center that is currently under construction will boost annual capacity to more than 1 million containers and 12 million tons of cargo.

Chengdu has one of the highest densities of expressways in China. There are currently two expressways leading to seaports: Chengdu-Chongqing-Shanghai expressway and Chengdu-Beihai expressway. A second Chengdu-Chongqing-Shanghai expressway is scheduled for completion in 2010.

### **Advantages and Challenges to Market Entry: Strong Growth Opportunities for Those Who Overcome Logistical Challenges**

#### **Sidestep Domestic Competition by Marketing U.S. Imports as High Value Products**

Differentiating U.S. products' quality, safety, and value capitalizes on their reputation with consumers. The growing number of affluent consumers in Southwest China is willing to pay a premium for a superior product. In response to safety and quality concerns, the presence of "green food," the Chinese equivalent to organic, in the supermarkets has exploded. Superior quality and safety helps to differentiate U.S. products from their domestic counterparts. This is critical when competition is strong, as it is for meats, fruit, and vegetables. For this reason, it is important that the integrity of imported products be maintained throughout the distribution chain from port city to emerging city markets. Further development of cold chain infrastructure is essential for maintenance of refrigerated product quality.

<b>Market Entry into Southwest China</b>	
<b>Advantages</b>	<b>Challenges</b>
<b>Growing middle class:</b> An estimated 35% of the 65 million urban residents in Southwest China are middle class or higher. This is projected to reach 50 percent by 2010.	Some <b>consumers not educated</b> about the superiority quality of certain imported products when local alternatives are available.
<b>U.S. products valued for safety and quality</b>	<b>Strong local competition</b> for fresh produce and some meat products
<b>Sichuan cuisine sets trends</b> for "Chinese" cuisine throughout all of China	<b>Limited infrastructure and distribution</b> , especially for perishable products; weak cold chain infrastructure
<b>Interest in trying new food products</b>	Geographical <b>distance from port cities</b>
<b>Marketing dollars go further</b> because of lower costs and less competition	<b>IPR violations</b> threaten product reputation and market share
<b>Retail outlets increasingly perceived as cleaner, safer</b> than traditional wet markets	Many local customers <b>perceive frozen meat as inferior</b> to fresh products.
<b>Hotel sector receptive to import promotions</b>	<b>Lack of importer and retailer knowledge and training</b> in purchasing, handling, and merchandising U.S. products

## Intellectual Property Rights (IPR) Violations Pose a Threat to U.S. Product Reputation

Throughout China, fraudulent labeling in the food sector is a problem, and Southwest China is no exception. An estimated 20 to 30 percent of products are counterfeit. IPR violation harms the reputation for quality and safety held by imported U.S. products and cuts into market share. Protecting intellectual property is a critical part of doing business in China. Avoiding infringement requires patent, copyright, or trademark registration with the appropriate Chinese registration office. Companies must also be proactive in pursuing enforcement mechanisms available to halt infringers.



Convincing counterfeits challenge IPR

## II. Roadmap to Market Development

### Getting Your Product to Market: Local Distributors, Importer-Direct, and Regional Distribution Centers

Selecting the most suitable distribution method with regard to the type of product and target market is crucial. There are three main channels for distributing food products to Southwest China: local distributors which purchase their product from port cities and then sell their products to retailers; regional distribution centers, normally associated with a single chain retailer; and importer direct, when retailers often working with a referred importer bring products directly from the port. Within the HRI sector, regional distribution centers are used primarily by quick service restaurant (QSR) chains, such as Yum! Brands, Inc. and McDonalds, for purchasing and logistics. Importer-direct is sometimes used by hypermarket and supermarket chains with less national presence or the hotel sector for specialty or highly perishable products, like some meats. Most imported meat is frozen.

Products directly purchased from port city importers and shipped directly to retailers or their central distribution centers are largely cash transactions. A significant quantity of imported products is purchased by local distributors from port city importers and then sold to the retail market. Most transactions with local distributors are carried out on a credit basis. Local distributors take on some of the retail risk by agreeing to the returns of expired or unsold products.

### Distributor Selection Important to Ensure Product Quality and Safety

It is imperative to determine that distributors have good cold chain facilities and shipping practices to ensure that product quality is maintained during shipping. Marketing U.S. products in China requires exporters to make certain that distributors are familiar with proper handling of unfamiliar imported products. Some local distributors have cold chain storage facilities with older-generation models that lack sufficient moisture and temperature controls necessary to maintain product quality on a consistent basis. Building close relationships with reliable distributors is highly beneficial, especially with the emphasis placed on relationships in Chinese business culture.

## Chengdu Market Profiles

### Chengdu's Booming Retail Food Sector: Upscale Hypermarkets Ripe for Promotion of Imported Products

Hypermarkets targeting the upper income and upper middle income levels are the most promising segment of the retail market for introducing imported products. The Chengdu upscale hypermarkets are Metro, Ito Yokado, Isten, Carrefour, and Auchan. They have the highest saturation of imported products. Sales of imported products in these hypermarkets represent 3 to 10 percent of revenues, with room for expansion. Predominantly wealthy Chinese consumers purchase these imported products. In Chengdu, there is a relatively small expatriate community, and only an estimated 15 to 20 percent of revenues from import sales are generated by foreigners. The market share of imported products in supermarkets and hypermarkets targeting middle to lower income consumers, i.e. TrustMart and WalMart, imported products is generally less than 1 percent of sales.

#### Degree of Centralization of Purchasing Determines Method of Entry into Upscale Hypermarkets

The first step to entry into the hypermarket sector is to ascertain the degree of centralization of the purchasing department. Retailers with less centralized purchasing systems give their individual store managers more control over the products that are on their store shelves. In general, it is necessary to work with the retailer's national import manager, their principle importers, and individual store purchasing managers.

#### Retailer Fees Can Increase Cost of Selling Product through Certain Retailers

Some retailers are known to increase the cost of doing business by charging slotting fees, shelf fees, festival fees, and chef fees. Some retailers charge promoters fees to have promotions in their stores, while others simply ask that the promoter provide the product to be given out in samples.

#### In-Store Promotions Essential for Success in Hypermarket Sector

In-store promotions like sampling, recipe cards, video, and chef demonstrations are critical to introduce products. Consumers are eager to try new, unfamiliar products, but if they do find uses for the product the first time they purchase it, they are unlikely to purchase it again. One retailer described how the store introduced a high quality biscuit, but over time the majority of the customers that purchased the product were those that had experience with the product overseas. The retailer believed the product would have been much more

Chengdu Retail Market at a Glance			
Targeted Clientele	Retailer	Ownership	# Outlets
HRI, Upper & Upper Middle income	Metro	German	1
	Ito Yokado	Japanese	3
Upper and Upper Middle income	Isten	Japanese	1
	Carrefour	French	5
Middle and Upper Middle income	Auchan	French	3
	Trust Mart	China/U.S.	10
Lower and middle income	WalMart	U.S.	3
	A Best	Chinese	2
	Century LianHua	Chinese	5
	Beijing Hualian	Chinese	4
	Wang Fujing	Chinese	1

successful if there had been an in-store promotion with samples to introduce uses of the product.

### **Hotel, Restaurant, and Institutional (HRI) Sector: High-End Hotels and Restaurants Increasingly Seek Imports for Specialty Promotions, Safety, and Quality**

In Chengdu, the most promising segments of the HRI sector for U.S. agricultural imports are five-star hotel restaurants and high-end restaurants. Chengdu's robust economy and international exposure set the stage for a large expansion in the hotel industry. The number of international 5-star hotels has more than doubled in the last 5 years and includes Starwood Hotels and Resorts Worldwide, Inc., Intercontinental Hotel Group, ACCOR Group and Shangri-la Group. The increased number of international hotels in Chengdu has expanded the opportunities for U.S food products.



Café Z at the Chengdu Shangri-La Hotel serves up local and international flavors

In addition to the international hotel chains, Chengdu also has several regionally-known 4- and 5-star hotels including the Jingjiang Hotel and the Minshan Hotel. Increased competition from their international counterparts has pushed local brands to upgrade hotel management, hotel facilities, and food service. Service and food quality have also improved drastically.

Chengdu has the most developed upscale stand-alone restaurant sector in Southwest China. As fine dining restaurants become more prevalent and establish reputations for quality and safety, they will increasingly compete with hotel restaurants. In Chengdu, the majority of fine dining establishments specialize in Chinese cuisine; however, the number of international fine dining restaurants has been increasing in the past few years.

### **Local Residents Turn to Hotel Restaurants for Prestige, Safety, and Convenience**

In contrast to first tier cities like Beijing, Guangzhou, and Shanghai, the majority of customers in hotel restaurants are local residents as opposed to in-house guests. Food and beverage managers in Chengdu estimated that 70 to 90 percent of hotel restaurant clientele were local residents. Hotel restaurants are held in high esteem as high-end establishments. Hosts earn face (respect from their guests) by selecting a hotel restaurant as a dining venue. The food safety and quality associated with international hotel chains also attracts residents to hotel restaurants. Convenience is another motivating factor. Dining in the hotel restaurants saves time for business travelers at conferences. Hotel restaurants have benefitted from the increase in the number of outside business visitors as the Southwest emerging city markets continue on the path of rapid economic growth. Five-star hotels are also major landmarks that are easy to find, making them optimal places to meet.

### **Hotel and Restaurant Promotions Often Showcase Imported Products, Boost Restaurant Revenues**

Food service makes up a significant portion—roughly one third—of hotel revenues in Chengdu. In 2006, food service accounted for \$197.9 million of Chengdu's total hotel revenue of \$567.2 million in 2006. Room revenue accounted for \$301 million.

Given the significance of food service revenues to hotels, short-term promotions are an important way for hotels to attract the attention of consumers. Successful promotions can

boost restaurant traffic significantly. Five-star hotels and upscale restaurants are constantly working to differentiate themselves from their competition. Promotions often feature foreign guest chefs and luxury food and beverage products, which are often imports. Holidays, like Christmas and Thanksgiving where 400 RMB per plate meals sell out, are common times for promotions. Examples of other recent promotions in Chongqing and Chengdu are Alaskan king crab legs, brandy and wine tastings, French and American food festivals, and Kobe beef.

### **Low Cost Nature of Institutional Food Service, Quick Service Restaurants (QSR) a Challenge to Imports**

Imports generally are not competitive in the institutional food service sector or the QSR sector due to its low cost nature. Most caterers are unfamiliar with imported products. In general, the catering industry in Chengdu focuses on providing lunch box foods. Commodity pricing ranges from \$ 0.7 to \$1.39 per unit.

Quick service restaurants (QSR) and chain restaurants have been rapidly expanding in Southwest China, but opportunities for imports are limited because both foreign and Chinese QSR chains predominantly use domestic sources to keep costs down. The two leading companies in Chengdu are Yum! Brands Inc. and McDonalds. The Chengdu Economic Commission reported that in 2006 McDonalds and Yum! Brands Inc. generated \$25 million and \$11 million in revenue, respectively.

### **III. Differentiating U.S. Products from the Local Competition**

Imported meats and produce face strongest competition from domestically produced products. The Southwest provinces are major agricultural producers. Lack of dependable cold chain and the transport time from port cities is a major obstacle. The majority of fruits, vegetables, and meat products offered in hypermarkets and supermarkets are locally produced. U.S. wine faces competition from numerous European and Latin American wines already present in the market. Post found that Canada, Denmark, and Norway are aggressively promoting their seafood products in the Chongqing and Chengdu hotel sectors.



"Green" meat products for sale in an upscale Chengdu hypermarket

### **IV. Select Best Product Prospects**

Interest in health, safety, and high-end gourmet products has increased with increased income levels. Consumers are increasingly buying produce from supermarkets and hypermarkets instead of traditional markets because they are perceived as cleaner and safer.

Post finds that these trends have led to opportunities for specific products. Health conscious products have been especially popular with the Chinese consumers. Red wine and olive oil have been widely accepted by Chinese consumers. Imported dairy products have increased in popularity due to the melamine dairy scandal, but dairy products face strong competition from New Zealand, Australia, and EU producers already in the market.

Selected U.S. Imported Products	Main Foreign Competitors	Domestic Competition
Red Meat	Canada, Denmark, New Zealand, Australia	Sichuan pork production, though lower quality
Poultry: esp. chicken paws & wing tips	Brazil, Argentina	Hunan chicken
Oranges	New Zealand, South Africa	Chongqing, Sichuan
California Table Grapes	Chile	Xingjian (seasonal)
Washington Apples	Chile, New Zealand	Hunan
Cherries	New Zealand	Sichuan
Breakfast Cereal	United Kingdom, Australia, EU	NA
Cheese and Dairy	New Zealand, Australia, EU	Domestic milk competition, little cheese production
Frozen Processed Products	Canada, New Zealand	NA
Wine	Australia, France, Italy, Spain, Chile	Xingjian, Hunan, Yunnan; generally lower quality
Spaghetti sauce/tomato products	Italy, France, EU	NA
Coffee	Japan, France, South Africa	NA
Candy and Chocolate	Switzerland, Italy, France, Belgium, Japan	NA
Nuts	Iran (pistachios), Mongolia, Korea (chestnuts) Russia	Xingjian
Seafood	Russia, North Korea, Canada, Norway, Japan	Little high quality competition, small scale farmed salmon operation in Sichuan province
Ginseng	Canada, Korea	NA
Dried fruit	France and Italy (prunes)	Xingjian, especially raisins
Baby food/infant formula	New Zealand, Switzerland	NA
Premium Ice Cream	France, New Zealand	NA

While there is strong local competition for meats, fresh vegetables, and fresh fruits, there is demand for specialty products and organic or “green” produce. U.S. imported produce could be successful if it is successfully marketed as a high value product. U.S. muscle meats, as well as chicken paws, wing tips, and other non-muscle meats are strong prospects, especially if sold as a high value product.

Hotels and high end restaurants use imported products primarily because of food safety and quality concerns or to differentiate themselves from the competition with specialty items. When comparable local products are available, hotels are unlikely to use more expensive imported products. Post finds that luxury or specialty products are especially strong prospects when reliable distribution networks are established. Food promotions that focus on American regional cuisine are promising, as well as food and wine pairing events. Demand from the HRI sector for Western products such as spices, condiments, and cheeses is expanding rapidly and few local substitutes are available.

**Select Products Present in the Market Which Have Good Sales Potential:**

Poultry; especially chicken paws and wing tips  
Oranges  
California table grapes  
Washington apples  
Cherries  
Breakfast cereal  
Cheese and dairy  
Spaghetti sauce/tomato products  
Candy and chocolate  
Nuts  
Seafood  
Dried fruit, especially prunes and raisins  
Premium ice cream  
Baby food/infant formula

**Select Products Not Present in Significant Quantities Which Have Good Sales Potential:**

Red meat  
Frozen processed products  
Wine  
Ginseng  
Peanut butter, other specialty condiments  
Oysters  
Other poultry, including turkey and quail

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