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## China, Peoples Republic of

### HRI Food Service Sector

### Annual Report

### 2009

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**Report Highlights:**

China's booming Hotel Restaurant and Institutional (HRI) sector revenue reached nearly \$230 billion by the end of 2007. The HRI industry, which emerged from a handful of government-operated cafeterias in the late 1970s, is now characterized by a highly diverse and evolving mix of national and regional food and lodging options. Transformation of the HRI sector has been fueled by China's growing urban affluence and increasing international exposure. As a result, more consumers demand healthier, faster, and safer food in hotels, restaurants and other institutions. Just as importantly, growth has spread to Emerging City Markets that are home to millions of emerging middle class and affluent consumers.

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## Executive Summary

### SECTION I. MARKET SUMMARY

#### A. The Economy: Slowing But Still Dynamic

Thirty years ago this year, China began its transformation from poverty and isolation into one of the world's most important economies. Spurred on by Chinese Communist Party leader Deng Xiaoping belief that "getting rich is glorious," China abandoned the planned economy with its Reform and Opening Policies. As a result, China has grown between 8 and 12 percent annually for three decades -- the fastest sustained economic expansion in human history. Per capita disposable income has grown at an average annual rate of 8 percent since 1990, drastically reducing poverty. In 2008, China became world's third largest economy measured by GDP – and second largest measured by purchasing power parity. However, because China started out so poor in 1979, per capita income remains modest. In just a little over 20 years, per capita GDP rose from \$107 to \$2,784 in 2007, a 26-fold increase. Depending on how the current economic crisis affects growth, per capita may reach \$3,558 by 2010.

The economic crisis is expected to sharply reduce China's growth rate, although outright contraction is still unlikely. Most economists estimate that China will grow at between six and eight percent in 2009. Although the current downturn has affected tourism, exports and other sectors, much of the Chinese economy appears resilient. Growth has been especially remarkable away the coast in the Emerging City Markets (ECM) of the interior where it continues in the double digits. While wealthier markets in Beijing, Shanghai and Guangzhou have lost momentum for now, cities such as Chengdu, Chongqing, Hangzhou, Qingdao, Shenyang, Wuhan and Zhengzhou continue to race ahead.

Major Economic Indicators at a Glance						
	GDP Growth (%)	Per Capita GDP (\$)	Total Value of Exports (\$100 Million)	Total Value of Imports (\$100 Million)	Per Capita Disposable Income (\$)	Per Capita Consumption Expenditure on Food (\$)
2006	11.6	2,377	9,689	7,915	1,729	458
2007	11.9	2,784	12,178	9,560	2,027	534
2008	6.8	2,973	NA	NA	NA	NA

#### *Income and Expenditure*

China has 22 provinces, four municipalities and five autonomous regions. The municipalities that report to the central government along with Guangzhou in Guangdong Province have the highest salaries and greatest wealth in China. Shanghai and Beijing have the highest average household expenditure at \$5,482 and \$5,127<sup>1</sup> respectively. The provinces with the highest average expenditures are Guangdong, Fujian and Zhejiang – all are located on the Southeast coast.

The number of urban households earning more than US\$5,000 a year is estimated to be growing by 24 percent annually, creating millions of new consumers. Around 5.8 million Chinese households already have "Western" levels of disposable income (US\$10,000 or more

<sup>1</sup> China Statistics Yearbook

per year)<sup>2</sup>. As growth spreads from the coasts, the consumer boom is expected to continue, despite the current economic slowdown. Based on official statistics, urban per capita disposable income in 2007 rose to \$2,027<sup>3</sup>. This was up nearly 18 percent compared to 2006 – and more than double the 2000 figure of \$923. The number of urban households with yearly incomes greater than \$5,000 is expected to grow by nearly 25 percent annually over the next ten years, potentially creating tens of millions of new middle-class Chinese consumers.

In contrast, many of the poorest households in China live on less than one U.S. dollar a day. For these Chinese, food and non-alcoholic beverages generally make up the biggest portion of household spending. Most of the poor households are located in the Southwest and include Guizhou and Sichuan provinces. In 2008, the devastating earthquake in Sichuan further lowered the expenditures in Sichuan. Another poor cluster of provinces is in northwest China and includes Tibet, Qinghai and Ningxia. These places have some of the lowest total household expenditures in China.

As a result of higher past growth on the coast, income distribution is very uneven – both between and within regions. In 2007, the average income for the richest 10 percent of households was US\$17,918, roughly 32 times that of the poorest 10 percent. While only 4.2 percent of households have an annual disposable income of over \$15,000, half of all households have annual incomes of \$750-\$3,000. At the same time, less than three quarters of households have a disposable annual income of less than \$5,000.<sup>4</sup>

Income and food expenditures are forecasted to continue to grow at a significant pace. McKinsey estimates 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 projected will nearly fourfold from 2004-2025, an increase in value of \$427 billion China-wide. By serving urban working households today, exporters gain exposure and experience necessary to stay relevant as incomes rise and consumer tastes evolve.

### ***Overview of Chinese HRI Sector***

China's domestic HRI sector first opened to international investment and domestic privatization as a result of Reform and Opening policies implemented since 1979. In the intervening decades, China's HRI sector has developed swiftly, thanks in large part to expatriates, overseas Chinese entrepreneurs, returning Chinese scholars, international and domestic tourists, officials on expense accounts, and an ever-growing cadre of affluent, middle-class consumers. In addition, the increasing number of international events held in China have also fueled demand and raised standards. As a result, international hotels, world-class restaurants, and high-end foodservice options have all emerged to meet growing demand, especially by Chinese consumers who have increased consumption expenditures in restaurants and hotels.

Today, China's urban wealthy and middle class consumers are the primary demographic targets of star-rated hotels, upscale restaurants, and other foodservice outlets. The number of Chinese middle-class consumers, defined as those with annual household income between RMB60,000 (\$7,322) to RMB 500,000 (\$61,016), range between 200-500 million based on A.T. Kearney, Inc. and Euromonitor International estimates. Consumers in the highest income tiers increasingly demand high quality luxury goods and analysts expect mid to high-

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<sup>2</sup> Source: Euromonitor International

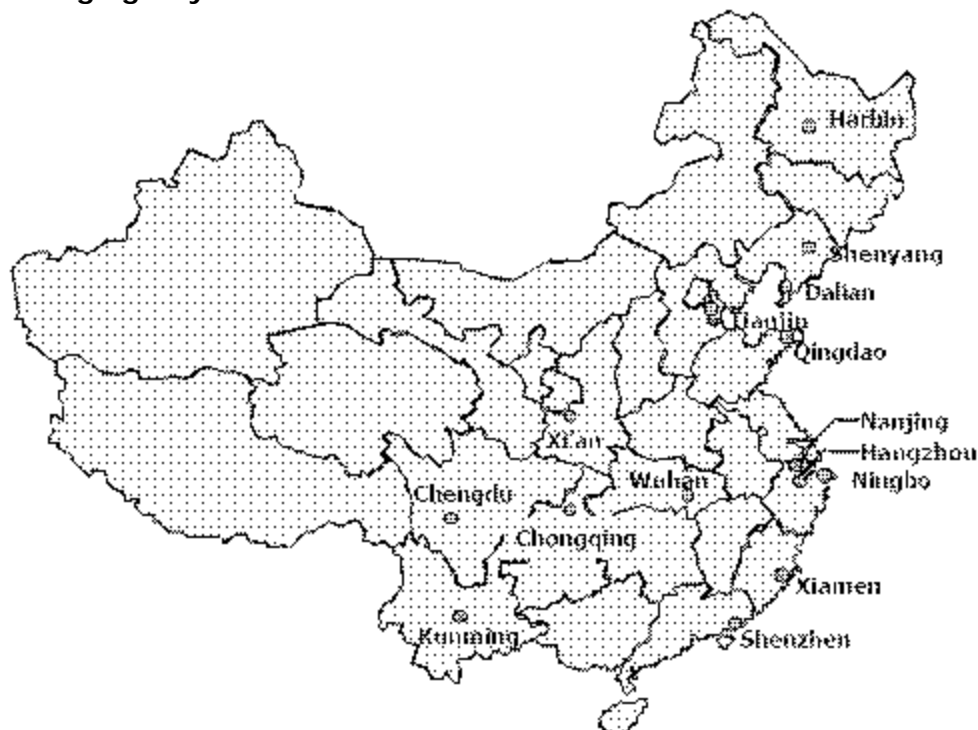
<sup>3</sup> Source: 2008 China Statistical Yearbook, page 315.

<sup>4</sup> Euromonitor International

end Chinese consumers to spend more than US\$650 billion on food alone by 2017. Most of China's middle-class lives in urban areas concentrated in Beijing, Shanghai and cities along the Yangtze River, as well as cities along Guangdong province's Pearl River Delta. Large urban centers along those regions such as Shanghai, Beijing, Guangzhou and Chengdu have above average per capita dining out expenditures.

However, in the next five years, the middle class is expected to spread to ECMs such as Chengdu, Chongqing, Dalian, Hangzhou, Harbin, Kunming, Nanjing, Ningbo, Qingdao, Shenyang, Shenzhen, Tianjin, Xiamen, Xi'an, Wuhan and Zhengzhou. These cities are home to almost 120 million residents.

### Emerging City Markets in China



### Regional Diversity

Food service industry in China varies across the regions. Chinese cuisine is made up of several distinct local cooking styles, with the culinary map of China divided into such regions. In Northern China, Beijing cuisine is famous for noodles, dumplings and pancakes. These products are made from wheat instead of rice, which is the staple grain of southern China. Cantonese cuisine is considered to be the finest of China's regional cuisines because of its fresh and varied ingredients. Sichuan (Szechuan) cuisine is often known for its spicy dishes, such as Kung Pao Chicken, Mapo Dofu, Szechuan Noodles or Orange Beef. Shanghai or Eastern Chinese cuisine is best known for slow cooking and the more frequent use of soy sauce, sugar and other seasonings.

### What and How Are We Eating

China is one of the world's largest producers of grain, cotton, oil plants, fruit, meat, eggs, aquatic products, and vegetables. As wealth increases and consumption patterns change, traditional supplies of food are increasingly unable to meet evolving consumer demands in the major cities. As people travel internationally and domestically, they also bring their culinary traditions with them across regions in China and from overseas. Consumers in major cities are demanding better tasting, stronger flavored and more authentic food.

Health-conscious consumers are willing to spend more on products that can deliver health benefits, fight aging process or are seen as safer.

Eating patterns are becoming more flexible and informal, particularly among the urban young and affluent consumers. 24-hour restaurants, Quick Service Restaurants (QSR), places offering light meals and snacks are emerging in response to the increasingly busy urban lifestyle, particularly in the major cities.

As disposable incomes rise, the younger generation and their families prefer to celebrate holidays and personal milestones going out to eat in restaurants or hotels. While time savings from eating out is important, many Chinese view dining out as a way to establish and maintain close personal and professional relationships. Dining establishments with a good ambiance, quality decor, prompt service, and high quality food continue to attract customers. Those that offer imported food and alcoholic beverages, dessert and coffee are especially attractive to affluent white-collar workers, professionals, and expatriates. Although the economic slowdown may cut demand at the most expensive restaurants, most are expected to weather the crisis well.



### ***International Influx***

Although tourism has increased substantially, most of the HRI market is dependent on Chinese customers. However, in the years to come, the situation is expected to change. Accession to the WTO benefited Chinese exporters while speeding the opening of the economy to foreign trade, investment, and travel. Current predictions estimate that by 2020, China will be the most popular tourist destination in the world with over 130 million international visitors expected annually. This trend is particularly noteworthy given that China's international tourism industry only began around 30 years ago. In just more than two decades after China opened its borders to global visitors, 22.21 million foreign visitors and tourists (excluding Hong Kong, Macao and Taiwan) collectively spent nearly \$30 billion.

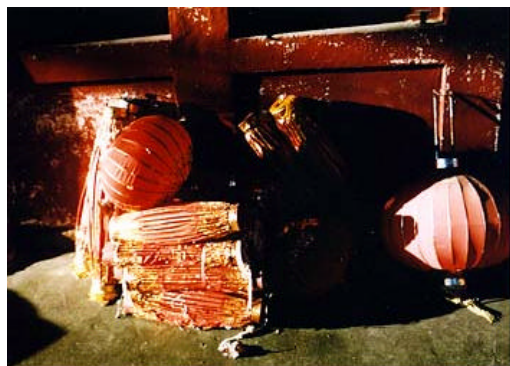
These overseas visitors working and traveling in China continue to significantly influence the HRI food service market by their demands for health and good tasting foods – many of which will be sourced overseas. International visitors will also inspire and influence the tastes of the wealthy, as well as fashionable and cosmopolitan young Chinese. Demand for high quality food products that meet stringent food safety standards will also continue increasing because of international events. Demand spiked increased during the 2008 Beijing Olympic Games in Beijing but stayed well above earlier levels even after the Games ended. Events such as the 2010 World Expo in Shanghai could also have the same effect.

### ***Business Meals***

Banquets and working dinners play a central role in Chinese business culture and support a large segment of China's HRI sector. This is particularly true in the major cities, where businesspeople with large expense accounts host officials, potential customers or other decision makers to extravagant meals. Seeking to impress a client or potential partner, it is not unheard of for these meals to cost thousands of dollars at a single sitting at high-end restaurants. As a rule, these customers are not price sensitive, since meals are paid by an expense account. However, these patrons often demand very private, peaceful, and comfortable dining environments. High-quality menu items and expert presentation also matter -- along with a good selection of domestic and imported beverages. Although the crisis has dented some consumption at high-level restaurants, this part of the business is not likely to fall significantly in the near future.



Despite the sophisticated nature of Chinese cuisine at many traditional restaurants, shortcomings persist in presentation, nutrition, ingredient quality and preparation. In addition, increasing demand for healthy food is supporting demand for foods that are organic, hormone-free and fat-free, with special attributes high antioxidant, omega-3, and fiber content. As the concern for health increases, well-heeled Chinese in first-tier cities will also continue to seek new and stimulating food experiences. This opens the way for imported products.



### ***Weddings, Holidays and Domestic Travel***

The wedding industry has become a multibillion dollar industry in China. Prior to couples tying the knot, they plan an once-in-a-lifetime event, which often includes an extravagant ceremony and banquet. The wedding industry combined with generally rising incomes has had a highly positive impact on China's HRI Sector, creating niche market for hotels, restaurants, and caterers.

Chinese holidays were updated in 2008 adding a few traditional festivals to the official list including Chingming, Duanwu and Mid-Autumn Festival. Until 2008, these holidays had not been officially recognized in Mainland China since the 1949 revolution. These restored holidays will likely assist the HRI industry since they provide a boost to domestic travel and dining out. As Chinese society rapidly modernizes, traditional festivals are becoming more important to ordinary Chinese. This trend will likely increase spending. During holidays, food service establishments often offer special holiday menus to attract families, couples, and businesspeople throughout the year. During traditional festivals such as Lunar New Year and Mid-Autumn (moon) Festival, reservations are often made 2 to 3 months in advance in stand-alone restaurants as well as hotels.

To encourage domestic tourism, the government has been upgrading travel-related infrastructure such as roads, seaports, airports, and tourist sites. Peak domestic travel time includes Chinese New Year, October 1<sup>st</sup> National Day Holiday and other short holidays. As China continues to open, develop, and grow, urban living standards continue to improve, and create many new HRI sector opportunities. Chinese are increasingly able to afford domestic travel. Rising incomes mean that every year more Chinese join a growing middle-class that can afford to travel. While there were only 744 million domestic trips in 2000 and this number exceeded 1.6 billion in 2007. Although the economic crisis will likely slow growth, travel is expected to resume rapid growth when the economy resumes its rapid growth. Travel out of the ECMs will likely grow particularly fast. As China's economy grows, business travel is also on the upswing, creating increased demand for travel accommodations.



### ***Food Safety Concerns***

More than 95 percent of Chinese consumers think about food safety before they purchase, and rank food safety as a "very important" factor influencing their food purchasing behavior. Food safety has become a major public concern in China over the past few years after multiple food safety scares reported by the local media.

The biggest scandal in 2008 was over milk products contaminated with melamine. Melamine is an industrial chemical, rich in nitrogen, and when mixed into milk, it creates a false reading that protein levels are higher than real levels. It is normally used to make plastics and fertilizers, and banned in food production. In the “San Lu” case, melamine was found in dangerously large quantities in milk powder, especially formulated baby milk powder. Those who drank tainted milk could cause potentially fatal kidney stones. Previous food scares includes antibiotic residue in fish, poultry and egg contamination with Sudan Red dye. The latter was reportedly fed to chickens so they would produce red egg yolks – with melamine added in to increase protein levels.

These and other health scares have brought greater scrutiny and tighter controls on food products and food safety. Reportedly, 621 food production licenses of 564 producers were revoked in an effort to improve food safety in 2007. In September 2007, the government launched a national campaign to improve food safety in the catering sector, focused on school dining hall and small restaurant inspections in particular. The website [www.51trace.org](http://www.51trace.org) was created to trace food product origin as well as provide food safety alerts and updates. Food product health and safety scares have served to increase consumer awareness about food safety and food origins. These developments could potentially be a boon for some food exporters since imported food and beverages, including wine, from the United States generally enjoy a good reputation for high quality and product safety standards.

The lack of cold chain logistics is another impediment of China’s food safety system. It is estimated China would need 365,000 refrigerated trucks and five billion cubic feet of cold storage by 2017 to serve China’s growing market with effective safety levels.<sup>5</sup> At the same time, increasing demand from restaurants and hotels are expected to stimulate demand for cold chain services. This interest in a large improved cold chain has been led by international chains such as McDonalds and Kentucky Fried Chicken. Now that the government is also focused on the sector, investment is likely to very substantial in the years to come.

## B. Sub-Sector Profiles

### 1. Hotels and Resorts

The World Tourism Organization (WTO) estimates by 2010 China will become the world’s most popular destination. Partially spurred by this and major events such as the 2008 Beijing Olympics and 2010 Shanghai World Expo, many international owned or managed hotel groups including Inter-Continental Hotels, Hong Kong based Shangri-La Group, Marriott and Accor Group increased their hotel numbers by 10 percent for 4-5 star properties prior to the 2008 Olympics.

China’s Hotel Industry at a Glance		
	Number of Star-Rated Hotels	Revenue (\$Billion)
2006	12,271	22.2
2005	11,228	19.8
2004	9,872	17.2

Source: China Statistical Yearbook

With the economic crises in end of 2008, hotel industry is facing low occupancy because of depressed business for banquets, domestic and international tourists. Although construction slowed in 2009, especially on the coast, it will likely accelerate when China’s economy recovers.

<sup>5</sup> Wall Street Journal, August 30, 2007.



Food service in hotel operations makes up a large part of total revenue. Unlike in many Western countries, restaurants in hotels are not necessarily visited by lodging guests, but are frequently visited by outside guests for their quality and unmatched service provided by international hotel management companies.

Hotels usually prefer to purchase in bulk and often as a group, especially for chained hotels. Group purchasing is often the rule. For example, a Shangri-la Hotel Group hotel needs fill-in online request from their group purchasing center to get order placed. Imported food products are often preferred by international hotels where multiple food service outlets on the premises cater to a diverse clientele. For international hotels, imported food products account for 30-50 percent of the total food purchases, making them some of the largest markets for imported food and beverage products.

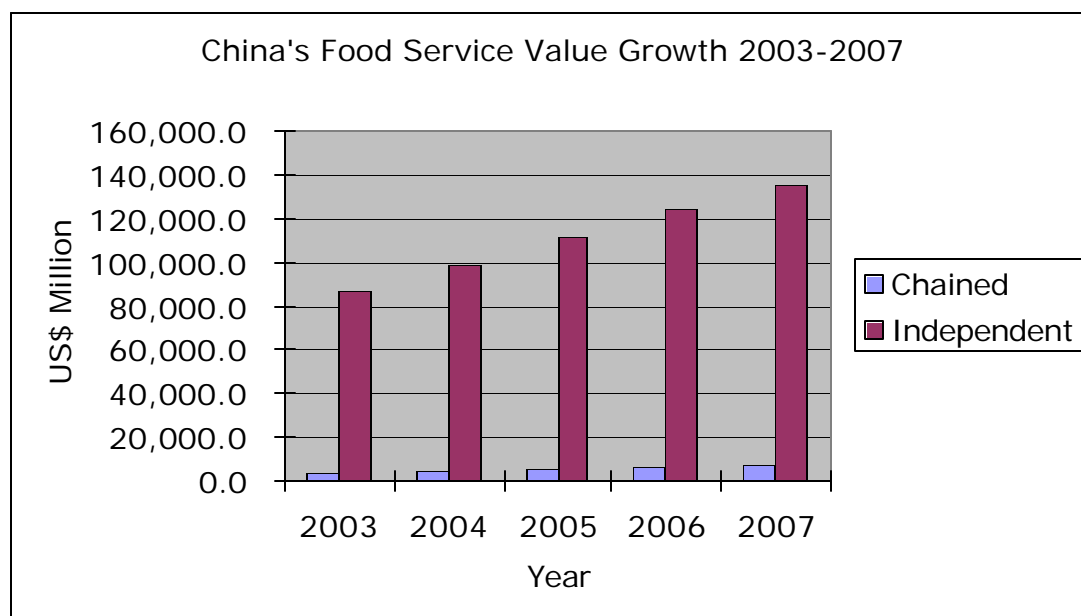
In comparison, many domestically managed, private or state-owned hotels purchase far less imported food than international hotels. As market pressures force improvements and modernization, their demand may grow. However, it will be limited by cost consciousness and the fact that these hotels traditionally focus their food service on Chinese cuisine, and depend mostly on locally grown products and ingredients.

## 2. Restaurants

Geographically large and regionally diverse, China has very distinct local and regional food and flavor preferences. Culinary styles differ widely by city, which necessitates regionally tailored product marketing strategies and effort. Among domestic consumer foodservice players, numerous well-known, distinctive local brands exist. However, only a handful of national brands that provide specialty foods enjoy widespread acceptance. Some of these include: Qianjude Roast Duck headquartered in Beijing; Xiaonanguo and YuanYuan in Shanghai; and Xiaofeiyang based in Inner Mongolia. Full-service restaurants are well positioned in major cities such as Beijing, Shanghai and Guangzhou. In addition to domestic food service players, increasing exposure and interest in foreign culture and travel means consumers are often interested in trying new Western-style foods. However, it is important to be aware of regional diversity when entering the China market -- which in fact is a series of many markets instead of one market. In general, supplies for non-chained establishments are sourced locally.

<b>China's Food Service Industry at a Glance</b>					
<b>Full Service Restaurants Value (US\$ Million)</b>					
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
Chained	4,501.1	5,327.3	6,381.7	7,305.7	8,254.9
Independent	99,945.2	113,653.7	128,450.3	142,605.3	155,469.4
Total	104,446.3	118,981.0	134,832.0	149,911.0	163,724.3

Source: Euromonitor International



Brand Shares of Chained Full Service Restaurants					
% Value	Global Brand Owner	2004	2005	2006	2007
Xiao Fei Yang	Inner Mongolia Xiao Fei Yang Foodservice Co. Ltd.	12.0	12.1	11.6	6.4
Xiao Wei Yang	Innner Mongolia Xiao Wei Yang Chained Food Service Co. Ltd.	7.8	8.3	8.7	6.2
Pizza Hut	Yum! Brands Inc	4.3	3.9	3.8	4.1
Chongqing Xiaotiane	Chongqing Xiaotiane Catering Group Co. Ltd.	3.8	3.5	3.4	2.6
Taoranju	ChongQing Taoranju Catering Culture Co. Ltd	2.1	2.1	2.1	2.1
Xiao Tu Dou	Shenyang Xiao Tu Dou Foodservice Co Ltd	2.2	2.3	1.7	1.5
Beijing Quanjude	Beijing Quanjude Group	1.0	1.0	1.1	1.0
Papa John's	Papa John's International Inc	0.1	0.3	0.5	0.7
Origus	Origus Pizza Works	0.4	0.5	0.5	0.6
Baguobuyi	Chengdu Baguobuyi Catering Development Co Ltd	0.4	0.4	0.4	0.4
TGI Friday's	Carlson Cos Inc	0.1	0.1	0.1	0.2
Big Pizza	Big Pizza Co	0.1	0.1	0.2	0.2
Hooters	Hooters Of America Inc	0.0	0.0	0.1	0.1
Sakae Sushi	Apex-Pal International Ltd	0.0	0.1	0.0	0.1
Domino's Pizza	Domino's Pizza Inc	0.0	0.0	0.0	0.1
Guangdong Shaoezai	Guangdong Shaoezai Group	1.6	1.2	1.0	
Others		64.2	64.0	64.6	73.9
Total		100	100	100	100

**Stand Alone and Chain Restaurants**

Although China's HRI sector represents a mix of different food trends, regional differences in first-tier cities are diminishing. Business visitors, tourists, students and expatriates have all contributed to the creation of a diverse, international dining culture. Many high-end restaurant chefs do not limit their creations to local products, evidenced by the widespread use of items such as *foie gras* and snow crabs. In fact, it is not uncommon for high value food and beverage imports to top the list on upper-end restaurant menus.

Affluent white-collar workers enjoy dining in international hotels or stand-alone restaurants featuring American, French, Italian, Thai, and other international cuisines to satisfy adventurous food cravings. The cuisine, restaurant, and ambiance are important in drawing affluent and often young consumers to these eateries.

Rising consumption, preferences for more dining options, attentive service and stylish ambiance has given full service restaurants and cafés/bars a boost across much of China. The number of specialty coffee shops and cafés also continues to grow rapidly. In addition, the popularity of premium restaurants in Beijing, Shanghai, and Guangzhou illustrates increasing preference for dining options that provide more than just good food. Café and bar chains, international and domestic, have been able to offer consistency and quality of food sought by consumers, leading dynamic growth in consumer foodservice outlets in China. For example, Starbucks offers ambiance, aroma and comforting background music. Wireless Internet access and comfortable seating encourage affluent clientele to leisurely enjoy their time while sipping coffee. Among young urban Chinese and expatriates, it is fashionable to meet friends in cafés rather than quick service or other restaurants, with places like Starbucks are often quote as landmark or meeting point. Premium restaurants are another form of lifestyle consumption as diners enjoy delicious meals in lavish environments that may include designer lighting, an intimate atmosphere, and high level of personal service.

Emerging middle and upper class consumers, now largely confined to a few major cities, continue to expand inland. Rising incomes in China have consistently produced interest in restaurants and cafés that offer more than just traditional food and beverage options. The appeal of dining options which offer superior food in a stylish setting is increasingly very widespread, continuing to create a market for high-quality food products that should continue expanding with China's development.

Western Cuisine requires a high level of consumer awareness, which has been transmitted by expatriates in major cities, overseas returnees and a small group of high-income earners who are frequently exposed to Western eating culture. Factors affecting understanding of western food include fast-paced lifestyles, accessibility to information, high spending power. Exotic cuisine is also on the rise as a result of international travel and the expansion of the food service industry.

**Restaurants – Quick Service Restaurants (QSRs)**

While fast food is often perceived as unhealthy by many consumers, it continues to enjoy significant growth in China. Although snack foods sold by street vendors have been around for centuries, this sector continues to decline in number given rising food sanitation-safety concerns. Longer working days in urban environments minus traditional leisurely lunch breaks have increased Chinese consumer interest in fast food, which is quick, hygienic, and inexpensive. Fast food sales values increased by nearly 10 percent reaching \$43 billion in 2007, and more than 1 million fast food outlets were reported in 2007, which represents an increase of over 6 percent from 2006. Successful fast food operators such as KFC and McDonalds created breakfast menus to cater to many white-collar workers who have limited time to prepare breakfast before leaving for work.

<b>Fast Food Industry Value at a Glance (\$ Million)</b>					
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
Chained Fast Food Restaurant	2,859.6	3,471.6	3,880.7	4,454.3	5,230.4
Independent Fast Food Restaurant	25,821.4	29,177.9	32,671.4	35,604.0	38,449.7
Total	28,680.9	32,649.4	36,552.1	40,058.3	43,680.1

Source: Euromonitor, converted from RMB to \$ at exchange rate of 6.8, rounded to 1 decimal place.

<b>Fast Food Industry Outlets at a Glance</b>					
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
Chained fast food	12,736	15,018	17,198	19,244	21,479
Independent Fast food	781,303	844,717	903,982	962,776	1,020,544
Total	794,039	859,735	921,180	982,020	1,042,023

Source: Euromonitor

<b>Brand Shares of Chained Fast Food</b>					
<b>% Value</b>	<b>Global Brand Owner</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
KFC	Yum! Brands Inc	38	38.3	40.7	40.9
McDonald's	McDonald's Corp	20.9	21.7	20.8	20.9
Dicos	TingHsin Int'l Group	7	7.9	8.2	9.5
Ajisen Ramen	Shigemitsu Industry Co Ltd	0.5	0.6	1.3	2
Kunfu	Kungfu Catering Management Co. Ltd	0.3	0.8	1.3	1.8
Malan Lamian	Malan Lamian Fast Food Chain Co. Ltd	1.8	1.5	1.3	1.2
Danian Gumppling	Jiangshu Grand Mother Dumplings	1	1.2	1.1	1
Haagen-Dazs	General Mills Inc.	0.8	0.9	1	1
Laobian Dumplings	Shenyang Laobian Dumplings Co. Ltd.	1	0.8	1	0.8
Mian Dian Wang	Shenzhen Mian Dian Wang Foodservice Col. Ltd	0.8	0.9	0.8	0.7
Others		27.9	25.4	22.5	20.2
Total		100	100	100	100

There are other reasons why people choose QSRs. One, the restaurants are mostly at prime locations, usually situated within shopping centers or where people travel the most. Two, they offer predictable food and decorations. As food safety outburst increase in China, a clean, bright dining environment with standardized set-up and service staff assures people for a good management. Modern deco also attracts students, young people and white collar workers. Three, it also offers consumers more meal choices than the traditional Chinese fast food.

Asian fast food offerings continue to dominate the market, with its sales value representing more than 50 percent of the total in 2008. Competition among fast food operators has

become increasingly fierce in some large urban cities; forcing market leaders to expand into smaller cities and inland areas.

Nutrition and health are major trends in the HRI sector including quick service restaurants (QSRs). With consumers increasingly aware of health implications related to consumption habits, QSR operators have had to adapt to consumer demand for more nutritious product offerings.

Since taste is the dominant issue for Chinese consumers, most international QSRs have adopted Chinese or Asian flavors and have changed their menus to adapt to local conditions. KFC's breakfast includes Chinese porridge and fried dough which are typical Chinese food. The ability to incorporate local flavor is key to success for international fast food players. KFC as market leader, had good success with incorporating Chinese elements into its menus to cater to Chinese tastes. Capturing multiple consumer segments such as those who prefer Asian-style fast food had enabled Yum! Brands to maintain its market leader position in China's fast food environment.

The country's one-child policy is also increasingly influencing the dining out preferences of Chinese families. Chinese often select restaurants based on the preferences of the child. International QSRs such as McDonald's, and KFC have succeeded in capturing market share by offering playgrounds, children's menus, toys, and birthday party packages designed to win the hearts and stomachs of young consumers. However, parents are also increasingly conscious of health and food safety considerations when selecting meals for their children. This could affect QSR and school foodservice providers in future years.

Although their low pricing limits the demand for imported food products, the QSRs are a good potential consumer of bulk products such as frozen potato products, meat, poultry, and seafood, ingredients as well as beverages.

### **3. Institutional Food Service**

#### ***Catering to the Masses***

Traditionally only hospital, government, school, transportation and airline employees were served by institutional foodservice. However, in the past few years, institutional foodservice has expanded into high-end office complexes and private companies.

It is estimated there are as many as one million domestic catering businesses in China, although a majority are small. In Shanghai, catering companies with annual revenues above \$10 million continue to emerge. Local surveys indicate 80 percent of consumers would like to try catered food or catering services – if the food offered is healthy, prepared according to industry standards, and convenient. As international players enter the Chinese food service market, it is critical they understand the pitfalls, including the absence of regulations and standards in the current environment. This includes a lack of transparency in such areas as contracting, food safety inspection, and taxation.

Due of extreme cost consciousness of much of the sector, the catering market is yet to reach a reasonable level of using imported food and beverage products, and most of the time, it is zero. However, with increasing wealth, there is more interest in catering private functions with higher quality food focused on international corporations, private functions and home events for expatriates. This has stimulated the rise of private catering companies offering high quality food, particularly in Beijing and Shanghai. Those high-end institutional niche food service companies could be a new market for imported products.

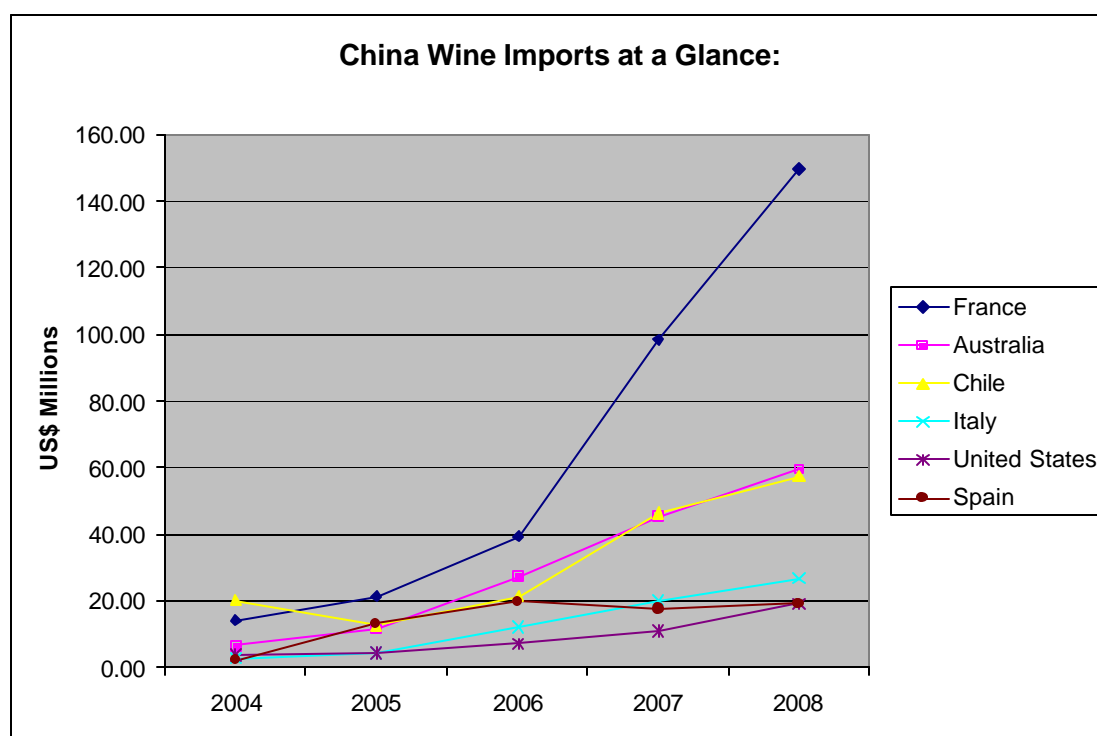
### ***If You Don't Like the Food, Have Some More Wine – China's Wine Market***

Chinese has a long history of consuming hard liquor (Bai Jiu), rice wines and beer. Wine made from grapes is still a niche drink in this market. Imported fruit wines and wines made of grapes are evolving in recent years with local products competing much of the market share. French wines remain at the highest end of the imported wine market since Chinese consumers equate French wines with superior quality. Australian, Chile and South African wines are also doing well in the market.

Wine shops, Western restaurants and five-star hotels are some of the key channels to promote imported wines. In addition, Chinese restaurants play an increasingly important role in developing the wine market, since they make up the biggest outlet type that Chinese consumers will choose.

In major cities like Beijing, Shanghai and Guangzhou, drinking wine, especially imported wine is often a status seeking activity. Wine culture is important in influencing consumers purchasing behavior since many consumers lack knowledge of food and wine pairing.

Major wine importers, distributors and retailers have been focusing educating consumers on wine first. Wine clubs are also very popular as people meet to learn more about wine pairing and appreciation. To some extent, wine is also becoming a collectable item like antiques.



Source: World Trade Atlas



## C. Regional Market Profiles

### 1. ATO Beijing Market Summary

Beijing is the capital of China, a major business hub, and a popular tourist destination. The city's total population reached 16.95 million at the end of 2008, of which 25 percent are migrants. According to a recent report by the Population Institute of Beijing University, Beijing's population is likely to soar to more than 20 million by 2020, largely due to the continued influx of migrants from other parts of the country. Beijing is also one of the largest and wealthiest cities in China with a per capita GDP exceeding \$8,000 and GDP passing \$146 billion in 2008.

Beijing's Major Economic Indicators at a Glance:							
Year	Per Capita GDP (\$)	GDP growth (%)	Per Capita Income (\$)	Per Capita Disposable Income (\$)	Annual Income	Per Expenditure on Food (\$)	Capita on
2007	7,654	13.3	3,614		3,234		726
2006	6,323	12.8	3,297		2,938		671
2005	5,548	11.8	2,873		2,596		620
2004	4,966	14.1	2,517		2,300		577

Source: 2008 Beijing Statistical Yearbook

Conferences, business meetings, corporate and diplomatic events that take place in an international capital like Beijing set the stage for billions of RMB spent on business lunches, dinners, banquets and receptions each year. Increasing international interest in China and a concentration of must-see historical and World Heritage sights drew more than 147 million tourists to Beijing in 2007 alone, reportedly generating \$30 billion in total tourism revenues.

The Beijing Municipal Tourism Administration reports nearly 143 million Chinese visitors come from every corner of the country visited the nation's capital, spending majority of \$25.7 billion in Beijing. Economic development and international exposure has translated into an increasingly sophisticated and adventurous clientele frequenting the city's ever-expanding list of diverse, upscale and new to market HRI venues.

2007 Beijing HRI Sector Reviews by Sub-Sector		
Sub-Sector	Registered Companies	Business Revenue (\$Million)
Star Rated Hotels	638	3,485
Restaurant*	1,475	2,684
Snack Counter*	115	730
Chain Catering Services	73	1,350
Total	2,301	8,249

\* Yearly Revenue over \$294,118 (2 Million RMB)

Source: 2008 Beijing Statistical Yearbook

Beijing also shares close ties with many Emerging City Markets (ECM) in North China – particularly Tianjin and Qingdao, with Hebei, Henan, Shanxi, Shaanxi and Inner Mongolia on the rise. These nearby cities and regions are increasingly affluent major domestic tourist attractions poised for rapid HRI sector expansion. Interviews indicate distribution networks of international food distributors have expanded over the last several years in servicing four and five star hotels throughout North China. Cuisine styles such as fusion or the 'Chinese

Kitchen' styles using US food products are on the rise. ATO Beijing has developed partnerships with local HRI operators and discovered significant interest in US food products from local trade, media and consumers. Despite growing interest, Western style cuisine is still relatively uncommon in Beijing among local residents, and many locals are unfamiliar with Western food or how to prepare it using ingredients which are foreign to them.

## Hotels

### *Continuing Swift Expansion*

Beijing continues to set new records for total rooms each year, and has the highest growth rate of new hotel buildings in Asia. The 2008 Beijing Olympic Games represented a unique opportunity for international lodging companies to establish their brands in Beijing, and throughout China. Shangri-La, Marriott, Hyatt, InterContinental, Accor, Starwood and Hilton are global market leaders in China, and continue to expand their presence in Beijing. The Hong Kong-based Shangri-La Hotel Group is a major player in Beijing with six hotels in town including four five-star hotels and two four-star hotels, of which two opened in 2008/2009. Another market leader Marriott Hotel group currently owns or operates 37 hotels/residential apartments in China, with ten located in Beijing. The Inter-Continental Hotel Group currently has 18 hotels in Beijing alone includes InterContinental, Crowne Plaza, Holiday Inn, and Holiday Inn Express.

### *Trends*

ATO interviews with chefs, food & beverage (F & B) managers at a number of star-rated hotels in Beijing and other north China cities confirm that imported food products make up a very substantial portion of hotel food budgets. Some leading five-star hotels in Beijing stated that imported food, beverage and wine products account for more than 50 percent of overall food-purchasing budgets and estimated that comparable full-service hotels have similar purchasing patterns. Food ingredients and meat products make up the bulk of the imported food purchased by these hotels. The newly opened JW Marriott Hotel adjacent to the new Ritz Carlton Hotel, for example, has five different food and beverage outlets featuring American, Italian, French, International and Chinese cuisine as well as lounges and bars. In general, the Western style food service operations such as steakhouses, for example, purchase a larger proportion of food imports than Chinese outlets. In addition, banquet and conference food service use a large proportion of imports in upscale hotels.

Beijing's star-rated hotels do not normally target price-sensitive consumers, but instead focus on business travelers, banquets and company events. In general, chefs and food & beverage directors believe that delicious, high quality food is their highest priority – and price is less important to their customers. Hotel food service operators also concentrate on creating trendy and attractive menus, incorporating high-quality food products emphasizing nutrition and health benefits. According to some chefs, "imported food, including American and European imports offer good food safety and quality control assurances prior to export, so we are very happy to purchase these products. We would also like to learn more about new American food service trends through media, promotion, and chef training to help us stay on the forefront of providing premium food service."

Beijing's high-end hotels are ideal venues for introducing new-to-market food and cuisine. Restaurants in international-branded hotels associated with stylish ambience, convenient location, highly trained chefs and wait staff tend to be open to using top-quality ingredients. Hotel dining has expanded beyond resident guests, with well above 50 percent of diners coming from outside the hotel.

Wedding banquets are again an important market niche for hotels. The newly opened Ritz Carlton Hotel currently has a special package for newly weds and owns the first-ever Wedding Chapel in a hotel here in Beijing to specifically target the wedding business! Hotel dining is also well positioned to capture the business entertainment market segment, and is a popular dining option for many business groups and individuals.

### **Restaurants**

Beijing is home to some of China's most sophisticated food culture. During the Ming Dynasty the capital was moved to Beijing with a diverse variety of foods from all over China finding their way to Beijing. In addition to the delicate and subtle flavors of Imperial cuisine, world-famous Peking duck, lamb hot pot are said to all have originated in Beijing. Now an international crossroads, Beijing diners savor the food and flavors of China's regional cuisine as well as an expanding range of international options. From the trendy Shanghai-based Element Fresh, that serves modern American cuisine with Asian twists, to the Legation Quarter, where top notch Chinese, French, New York, Spanish and Japanese cuisines are offered in the former U.S. Legation, the palates of Beijingers continue to expand along with their pocketbooks.

### **Trends**

Beijing's place is a center for top universities, central government agencies, international diplomatic missions, and the global business community. This puts the city on the leading edge of global dining trends. Initially inspired by returned overseas Chinese and expatriates, affluent local Beijingers are now part of the driving force behind a strong interest in diverse dining options. Interviews with food service managers reveal that today's Beijing diners are becoming more health conscious when it comes to choose dining outlets and menu items, particularly those with high disposable incomes. This is a major change from just a few years before, where people are willing to try almost anything, considering the abundant cuisine and restaurant choices. According to the Beijing Western Food Association, the number of restaurants serving international cuisine is expected to more than double between 2004 and 2008, from over 1,000 to more than 3,000 restaurants. Price increasingly takes a backseat to perceptions of lifestyle; customers expect that the food will be excellent and have turned their attention to service, ambiance, and, creative restaurant themes. Wine tastings and dinners are a common occurrence and continue to attract the city's affluent.

Beijing's size means that, like most metropolitan areas, location plays a large role in restaurants' client base and success. The Central Business District (CBD), stretching across central and eastern Beijing, is home to many of Beijing's best restaurants. Many fashionable new dining destinations are located in or near the CBD, including The Place, Shing Kong Place, Block 8, and Solana, all are home to multiple restaurants serving a wide range of international cuisine. Convenience for young and wealthy Chinese professionals and proximity to businesses and embassies likely to expense lunch or dinner make the CBD prime real estate for many high-end dining establishments.

Sichuan style is one of the most popular cuisines in Beijing, along with Hunan, Cantonese, Shanghainese and Dongbei styles. Many will tell you it is hard to find real Beijing food, and those places claim serving authentic Beijing specialties, such as Quanjude for Beijing Roast Duck, are mainly for tourists.

Beijing's nightlife continues to be dominated by increasingly sophisticated bars and clubs in the Sanlitun, Workers Stadium, and Houhai areas, catering to wealthy affluent young professionals. Many of those nightlife neighborhoods are filled with high-end dining options, and have international cuisine or snacks on the menu with imported food and beverages.

**Institutional Food Service**

Cost-conscious young professionals seeking convenient dining options, largely drive Beijing's institutional food service at this point. As property values rise across Beijing's Central Business District (CBD), 30-story office buildings have replaced many local mom-and-pop eateries. Professionals who don't want to pack a lunch are left scrounging for options. Most office buildings over ten stories have outsourced cafeterias managed by Chinese companies located in the basement, but quality food products are not readily available - even at the best international office complexes. Cafeteria lunches range from around 10-20 RMB (US \$1.3-2.6), and generally include a number of Chinese-style main and side dishes, rice, bread and soup. While bulk imported food products such as flour and oils may find a market here in coming years, the price point of cafeteria food service in Beijing, and in the rest of China, still does not accommodate the incorporation of high value imported food and beverage products.

Domestic catering services such as old-time Lihua Fast Food is one of the largest food delivery companies in China, and is still widely accepted and popular in Beijing. It delivers single lunchboxes to offices or home for a fee ranging from RMB10-30. Like many catering services, Lihua has no storefronts and orders are placed by phone. Lunchboxes are delivered by teams armed with maps on bicycles. Orders are guaranteed to arrive within 30-45 minutes after the order is placed, or your money is refunded. Newly emerged on-line catering services 'Goodies' and 'Isender' have developed amazingly successful business module to deliver food from several of the major restaurants around town to anywhere in the city. Customers place orders by phone, which are relayed to food production centers via Internet. For an increasingly overworked workforce, it is certainly a convenient, relatively inexpensive, and time-saving meal solution.

As catering services continue to develop in Beijing, current domestic players are not fully successful in satisfying the increasingly high nutritional, hygiene, price, and efficiency expectations of consumers, there is still room in this market segment and more market players are emerging to compete, forcing domestic old-style catering service to change or to be out of the game.

The rise of office and home delivery services has brought more players into the institutional and catering market in Beijing. Global brands such as Aramark, which was an official caterer for the Beijing Olympics, is taking the lead in high-end institutional food service. On the other hand, most of Beijing's full-service restaurants and major fast food outlets also provide delivery services as well. International brands such as Pizza Hut, Papa Johns, and Domino's continue to introduce higher-profile delivery to homes and offices. At the same time, many local restaurants such as the Italian-American Annie's chain have also introduced home delivery.

## 2. ATO Chengdu Market Summary

ATO Chengdu covers Southwest China, including Sichuan, Chongqing, Yunnan, and Guizhou provinces. One in every 33 people on earth lives in Southwest China. With a population of over 200 million and a regional gross domestic product (GDP) of \$290 billion in 2007, the area is over twice the size, six times the population, and three times the GDP of Central America. The economic growth the region is experiencing is raising incomes and increasing the market for foreign products. The region 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 percentage of disposable income in the country on food away from home. |

Economic growth and increased incomes are fueling increased expenditure on food and beverage sales. Growth rates in regional domestic product in the provinces of Southwest China are some of the highest in the world, averaging between 12.0 and 15.6 percent in 2007. Growth in the region's two largest emerging city markets (ECMs), Chengdu and Chongqing, reached 17 and 18 percent, respectively, in 2007. These two cities account for 20 percent of the region's population.

Rapid Growth in Value of Imports (million USD)			
Province	2006	2007	2007 Growth in Imports
Sichuan	4996.7	6303.3	26.15%
Chongqing	2118.7	2937.9	38.67%
Yunnan	2833.3	4508.2	59.11%
Guizhou	579.3	1161.5	100.50%
Tibet	2156.0	2663.0	23.52%
Source: 2008 China Statistical Yearbook			

### A Burning Hunger: Southwest China's Passion for Dining Out

#### Southwest China Dining Out Expenditures, Growth

Province	2000	2007	2000-2007 % Increase
Sichuan	499.26	662.11	32.62%
Chongqing	271.65	471.92	73.72%
Yunnan	137.23	239.66	74.64%
Guizhou	240.15	503.08	109.48%

Source: Global Insight Regional Food Consumption

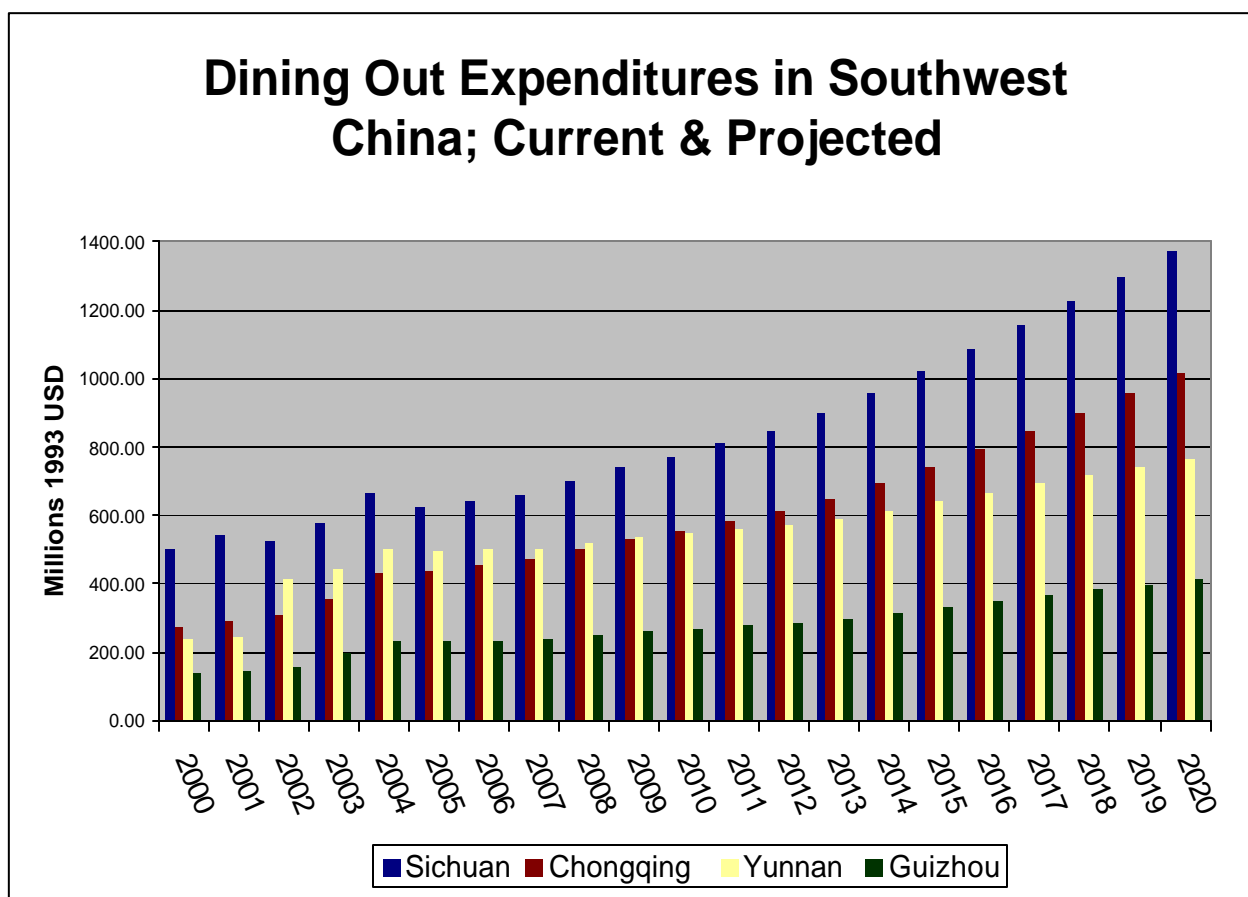
The traditional food culture and robust economy has benefited the restaurant industry. Eating out is a tradition in southwest China, particularly in Sichuan society. Residents enjoy relaxing and sharing time and diverse foods with family, friends and business associates. It is common practice to dine out in more upscale restaurants for special occasions like Valentine's Day, Chinese New Year, and even Christmas. Consumers are willing to pay a premium for quality and

international dining experiences as their incomes rise. The booming economy continues to expand the economic roles of middle class and white-collar workers. The May 12, 2008 earthquake in Sichuan has increased many residents' passion for life and willingness to spend on quality-of-life products, including food.

Tourism and foreign investment have led to increased interest in foreign food cultures and imported products. There has been an increase in foreign food establishments outside international hotels, particularly in Chengdu and, to a lesser extent, Chongqing, the two largest emerging city markets in the region. As incomes have increased and tastes have been influenced by Western food culture, consumers are increasingly attentive to food safety and food nutrition.

Southwest China Tourism Revenue(million USD)			
Province	2006	2007	2007 Growth in the Revenues
Sichuan	395.0	512.0	29.62%
Chongqing	309.0	382.0	23.62%
Yunnan	658.0	860.0	30.70%
Guizhou	115.0	129.0	12.17%
Tibet	61.0	135.0	121.31%
Source: 2008 China Statistical Yearbook			

Influenced by this trend, 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 foreign ingredients. This has been a boon to western-style inputs, like dairy products, and imports, including imported meats and seafood. The "new Sichuan cuisine" not only challenges traditional Sichuan cuisine, it also impacts food consumption patterns throughout China.



Source: Global Insight Regional Food Consumption



## Chengdu & Chongqing: Emerging City Markets Ripe for Development

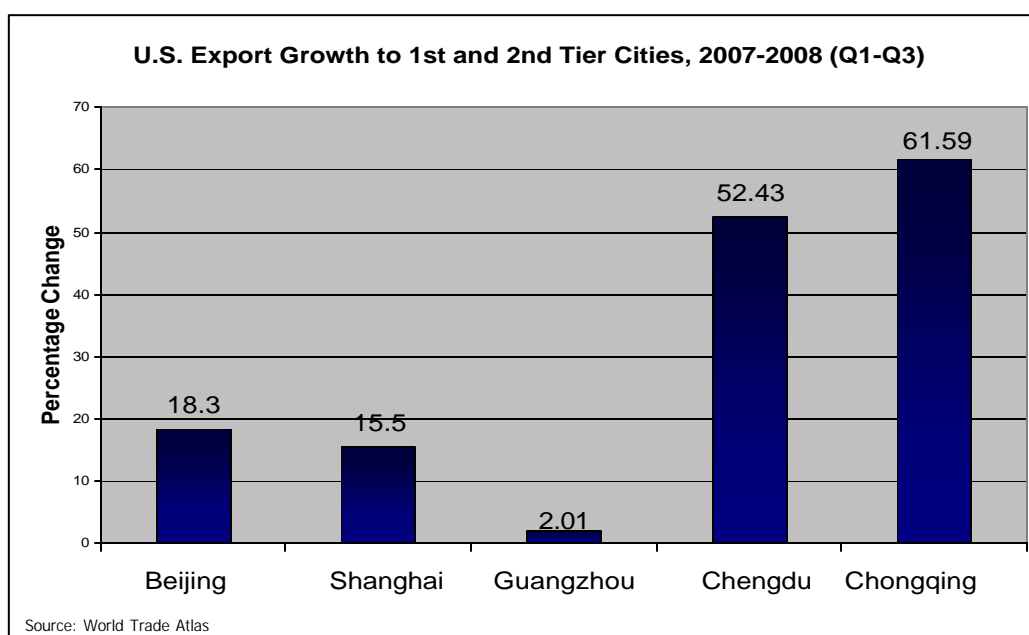
The markets of Southwest China are less saturated with imports than developed port cities, providing several advantages to marketing products in the region. There is less foreign competition despite burgeoning demand. Marketing dollars go further in the region because new imports face less foreign competition in Southwest China than in the saturated markets of the more developed port cities. Additionally, 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.

### 2007 Disposable Income per Capita Growth Rate

Sichuan	4.8%
Chongqing	5.3%
Yunnan	3.8%
Guizhou	3.8%

Source: Global Insight

Chengdu, the capital of Sichuan province, is the wealthiest and most advanced city in the region. Chengdu currently has the largest market for imported products in the HRI sector and the most developed hotel and restaurant sector. Chongqing is growing rapidly and is experiencing rapid expansion of its hotel sector, and it is only a few years behind Chengdu in terms of income level. Incomes in Kunming and Guiyang are less developed than in Chongqing and Chengdu, but provide significant opportunities as well.



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

The majority of customers in hotel restaurants are local residents as opposed to in-house guests. Food and beverage managers in Chongqing and 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 Promotions Often Showcase Imported Products, Boost Restaurant Revenues

Southwest China Hotel and Catering Service Revenue (million USD)			
Province	2006	2007	2007 Growth in the Revenues
Sichuan	625.5	761.6	21.76%
Chongqing	194.3	235.7	21.31%
Yunnan	178.1	231.9	30.21%
Guizhou	76.1	116.3	52.83%
Tibet	15.8	18.8	18.99%
Source: 2008 China Statistical Yearbook			

Food service makes up a significant portion—roughly one third—of hotel revenues in Southwest China. 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 hotel restaurant traffic significantly. Five-star hotels 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.

## Chengdu's International Hotels Raising the Bar for Local Competitors

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. Large numbers of sophisticated business travelers and tourists expect top-quality food and service, with a spicy Sichuan twist.

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.



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

## Projected Growth Fueling Expansion of Chongqing Hotel Sector

The hotel industry has taken note of Chongqing's rapid ascent. Hotel companies are racing to get a foot in the market before it is fully developed. Even though there are already several international five-star hotels in the market, there are plans in the next few years for a Kempinski, Westin, Shangri-la, second Hilton hotel, and two Sheraton hotels. Some food and beverage managers forecast that the market will mature significantly over the next two years. Tourism associated with Yangtze River cruises draws visitors to the city, and Chongqing is increasingly a business center as a government-designated special economic development zone.

## High-End Restaurants the Largest Market for Imports in Restaurant Sector

The next largest market for agricultural imports in the HRI sector is stand-alone upscale restaurants. Chengdu has the most developed upscale restaurant sector in Southwest China. The markets in other cities are developing, particularly in Chongqing, but have not yet



McDonald's is one of the most dominant international QSR chains in SW China

matured. As stand-alone 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. Euromonitor International reports that in 2007 North American full-service restaurants saw the fastest growth in value of sales China-wide at 30 percent. The full-service restaurant sector is highly fragmented; chain restaurants only account for 5 percent of total sales.

Quick service restaurants (QSR) and chain restaurants have been rapidly expanding in Southwest China, but opportunities for imports are limited. Both foreign and Chinese QSR chains predominantly use domestic sources for their products to keep costs down. For example, an iconic deluxe hamburger sold by a popular U.S. chain contains only one imported product when sold in China—imported beef fat is added to the patties because the Chinese cattle are so lean. The two leading companies in the region 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.

## Low Cost Nature of Institutional Food Service a Challenge to Imports

Imports generally are not competitive and most caterers are unfamiliar with imported products. In general, the catering industry in the Southwest focuses on providing lunch box foods. Commodity pricing ranges from \$ 0.7 to \$1.39 per unit. Where imports are not the low cost input, the low price of catered products makes it difficult for imported products to compete. Further, most catering is performed by in-house service units. As a result, many catering services lack knowledge of and experience using imported products

The upscale catering industry in Chengdu is in the initial stages of development. Most five-star hotels and some high-end restaurants now offer off-site catering services targeted towards special occasions. The international business community, including companies like Intel, Motorola and Nokia, has reported using these nascent services.

## Strong Growth Opportunities for Those Who Overcome Logistical Challenges

Consumers are interested in quality food products, and the local food culture promotes experimenting with new food products. Another asset is the reputation of U.S. products. They are held in high esteem for their quality and safety, and hotels and restaurants use this to their advantage to attract customers to their restaurants with promotions featuring U.S. imported products.

Key obstacles include logistics and fraudulent labeling of imported products. The distance from major port cities such as Shanghai and Shenzhen is a challenge for some U.S. imports.

Except for air transport, port to retail transportation time is from two to five days, and the cold chain is not always reliable.

Throughout China, fraudulent labeling in the retail sector is a problem, and Southwest China is no exception. Consumers are often not aware of how to determine if a food product marketed as U.S. imports are genuine. Intellectual property rights violations harm U.S. products' reputation for quality and safety and cuts into market share.

Market Entry into Southwest China	
Advantages	Challenges
<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
<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

### 3. ATO Guangzhou Market Summary

The booming economy and active trade further promote expansion of the hotel and restaurant sector in South China. According to official data, the province of Guangdong recorded US\$8.49 billion sales in the HRI sector. Though the latest 2008 figure is not available yet for the province, the industry expects at least a 15 percent increase. However, industry sources said the actual number would be much higher at about US\$20 billion.

Guangzhou, the capital city of Guangdong province and also known as the center of food, recorded US\$5.88 billion sales revenue in the HRI sector in 2008. The Pearl River Delta, including Guangzhou, Shenzhen, Foshan, Dongguan, Zhongshan and Zhuhai, contribute most to the province's HRI revenue. Guangzhou's per capita dining out expenditures reached US\$603 in 2008, or 20 percent of disposable income, which was the highest in China.

By the end of 2008, Guangdong alone boasted 58 five-star hotels and 168 four-star hotels, while more luxury hotels are set to open before the 2010 *Asian Games* in Guangzhou. Western style fast food chains continue expansion in China through introducing more items for local palate while Chinese cuisines dominate food service.

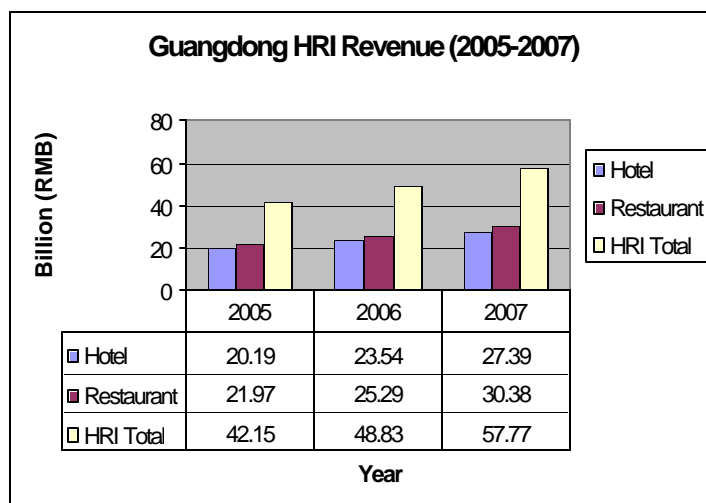
Wealthy local consumers, expatriates, visiting businessmen and tourists pursue good tasting and quality foods, which create a potential market for imported food products from the US.

#### 2007 Guangdong HRI Revenues by Sub-sectors

Year	Star rated hotels	Number	Restaurant above designated size *	Number
2007	US\$4.03 billion (RMB27.39 billion)	1,209	US\$4.47 billion (RMB30.38 billion)	1,890

- Remarks: "Restaurant above designated size" means restaurant with annual sales greater than US\$294,000 (RMB2 million)

(Source: 2008 Guangdong Statistics Yearbook)



(Source: Guangdong Statistical Yearbooks)

The frightened consumer from recent food scandals has turned to imported foods, especially milk powder, infant foods and dairy products, for reliable quality and food safety concerns.

Local chefs like to use imported products to add extra value and nutrition to dishes. U.S. beef, high-value seafood, poultry, dried nuts, frozen potato products, sauces, and seasonings are widely used by South China chefs.



## Hotels

The hotel sector is well-established in major cities in South China such as Guangzhou and Shenzhen, while emerging cities, such as Zhuhai, Dongguan, Fuzhou, Changsha, Xiamen, Sanya, and Guilin, are catching up rapidly.

The booming local economy and strong demand from business travelers spur investment in the high-end hotel sector. Take Guangzhou as an example. Several luxury hotels including the *W Hotel*, *Jumeriah Hotel* and *Sheraton Hotel* are under construction and set to open by 2010.

However, the hotel sector already feels the impact of the global economic slowdown. The *Canton Fair*, the largest export oriented exhibition in China and regarded as the barometer of Chinese exports, saw fewer visitors and less orders from the US, Japan and the EU. Hotel prices normally doubled or even tripled during the show period. However, given many businessmen from these countries tend to stay in high-end hotels, the decline in overseas visitors have made Guangzhou's four to five star hotels suffer even more this past October. An interviewed hotel manager said it was the first time that his hotel offered regular prices during the *Canton Fair* period, and the hotel had less than 60 percent of occupancy.

As is the case with most hotels, food and beverages (F&B) make up most of total revenues. Increasingly, hotel management leverage F&B operations as a branding positioning strategy by offering distinct styles and tastes to appeal to niche markets. Many feature imported ingredients and hold promotions to attract local consumers. With this in mind, high-end hotels are an influential brand or product launching platform into South China.

It's common practice in South China for four and five star hotels to allot US\$10 per person to the kitchen for breakfast buffet. This allows chefs to include imported breakfast cereals, butter and cheeses, fresh fruits and otherwise difficult-to-find seasonings for overseas tourists to feel more at home during their stay.



To source such specialty foods, chefs tend to work with reputable local distributors or through the German retail giant *Metro*. While more regular ingredients (such as rice, wheat flour and cooking oil), are purchased through central purchasing divisions within the large hotel chains for cost control.

Budget hotel chains and international management franchises are entering this market segment. Many offer services normally available in higher rated hotels such as broadband services while room rates remain competitive at US\$29-51 (RMB200 to 350). Such strategies are gaining traction and winning price conscious business travelers away from the higher rated and more expensive

hotels. One good example is the *7 Days Inn Group* that have been successful in penetrating this end of the market, having now opened more than 100 properties across China.



## Staffing Challenges

South China hotel and restaurant operators face staff shortage and rising labor costs. Higher salary offered by newly opened luxury Las Vegas style hotels in Macau as well as competition from other industries have siphoned trained staff and management professionals from local hotel and restaurant businesses. Hotels and restaurants have to either raise salary to keep trained staff or hire less experienced newcomers.

## Impact of Financial Crisis

The HRI sector in South China, especially the high-end restaurants and hotels, already feel the brunt of the global financial crisis. Industry insiders say they expect at least a five percent hit in 2009. The hotel industry is expecting fewer business conferences and banquets from companies, that attempt to lower operations cost. Some interviewed high-end restaurants said they received less orders for business banquets, and the dining budget was shrinking. Many have started to offer discount prices or special set menus at promotional prices to attract consumers. Meanwhile, fast food chains and middle to low-end restaurants, which offer competitive prices, saw steady increases in diners.

Many restaurants offer innovative menus with focus on health, nutrition and taste. It's believed that the incorporation of imported ingredients would be a good selling point to consumers. Restaurants provide cash coupons, free desserts or fruits and discounted prices to attract more consumers. Some restaurant chains also sign bulk purchase contracts with farmers to lower purchasing costs.

The industry believes consolidation will continue, and those with financial and resources advantages will survive from the crisis.

## Guangzhou

At the end of 2007, Guangzhou had 209 star-rated hotels, of which 39 were recognized as four stars and above. However, further expansion is expected by industry insiders as Guangzhou prepares to host the *2010 Asian Games*. Guangzhou's hotel sector served 33.39 million domestic and international visitors in 2007. The recent available figures state that total revenues for Guangzhou's hotel sector was US\$11.74 billion (RMB79.82 billion) in 2007, up by 13.94 percent from the previous year.



*Proper training on U.S. cuisines and ingredients are always welcomed by South China Chefs*

*(Source: ATO Guangzhou)*

## CBD, hot new location for high-end hotels

The *Zhujiang New Town* is the new Central Business District (CBD) in Guangzhou. According to the development plan, the new CBD area will house nearly ten luxury hotels once completed. The *Ritz Carlton*, one of the luxury hotels, already opened its first in South China in 2008; while several other international hotel brands are building their hotels in this area, including the *Grand Hyatt*, the *W hotel*, the *Jumeriah hotel* and the *Park Hyatt*. Industry insiders also say that the *Four Seasons Group* plan to build their first hotel in South China in the CBD area.

## 2010 Asian Games in Guangzhou

Guangzhou will host the 10<sup>th</sup> Asian Games in 2010, which is one of the most highly recognized events in the Asia Pacific region. An Asian Games Town is under construction in Panyu, less than an hour's drive from downtown Guangzhou. To meet accommodation requirements by the flood of visitors, the city government has approved ten new high-end hotels for this hallmark event.

## Shenzhen

Shenzhen's stellar economic development over the past 30 years has kept the hotel sector flourish. By the end of 2007, Shenzhen had 151 star-rated hotels, of which 37 were rated four stars and above. The total revenues were US\$7.52 billion (RMB51.11 billion) in 2007.

Only a 30 minute train ride away from Hong Kong's downtown, international visitors are attracted to stay overnight in Shenzhen because of its more favorable room rates. To prolong stays, Shenzhen developed amusement parks with resort style hotels targeting families from the mainland, Hong Kong, Macau and overseas.

## HRI situation in ECMs

The hotel and restaurant business is booming in newly emerging markets. Many international brands entered second and third tier cities to capture lucrative profits.

## Guilin

Known as one of the best tourist attractions in China, Guilin welcomes 1.29 million tourists in 2007, and over 60 percent were from overseas. Many hotels have been built to accommodate a growing number of visitors. The urban area in Guilin has four five-star hotels and seven four-star hotels. Yangshuo County, an hour ride from Guilin, has two four-star hotels and 18 hotels said to be equivalent of four-star. International hotel brands are entering the high-end market in Guilin, such as the *Sheraton*, *Shangri-La* and *Grand Mercure*. Both domestic and foreign investments are pouring into Guilin's HRI sector.

The peak season is from April to October. Fifty percent of guests are from Hong Kong, Macau and Taiwan while twenty percent are from foreign countries, mostly Europe and the United States.

One hotel manager mentioned that many European and U.S. tourists miss western foods such as beef steak. Given the current import ban on U.S. beef, hotel restaurants serve Australian or New Zealand beef instead. Experienced customers can easily differentiate U.S. beef, which is deemed the best, from those produced on the Oceanic continent. A set menu including New Zealand beef steak as the main course is priced at US\$28 (RMB190).



Cafe/Pizza restaurant/bar on West Street in Guilin  
(Source: ATO Guangzhou)

All imported ingredients or meat are sourced from Guangzhou. Although guests have a strong demand for fresh imported fruits, restaurants serve mostly local produce since distributors are more willing to guarantee quality and assume liability for food safety related problems.

Timing is critical in conducting market promotions for U.S. food products. Sometime between May and October is preferred to catch the peak tourist season.

Unlike other Chinese cities, western style of cuisine is the mainstream in Yangshuo County, where popular among foreign tourists and white collars. It's no surprise to find out that the price tag in Guilin is close to the major cities like Shanghai and Guangzhou.

The Guilin HRI market is a viable yet undeveloped market for U.S. foods. U.S. beef, frozen meat, condiments, baking ingredients and wines could enter the Guilin market through promotions.

Infrastructure improvements will enable imported products, particularly perishables gain easier market access to Guilin.

Like many other places, chefs in Guilin have limited experience and knowledge in handling imported products. Thus, chef training is needed to nurture the market.

### **Dongguan**

The 16,500 foreign investments and 160,000 private businesses made Dongguan an extremely attractive place to HRI entities. By the end of 2008, Dongguan is said to have the most condensed star-hotels in the world, with 23 five-star hotels in town. Most of the guests are businessmen who tend to stay at luxury hotels and dine at fine restaurants.

According to industry sources, the average hotel occupancy rate is about 75 percent. The wealthy Dongguan consumers like to spend in high-end restaurants in a five-star hotel, believing its quality and service. Dinners of the high class restaurants and cafes are 60 percent local consumers and 10 percent expatriates. Chefs of these international brands are either westerners or gained extensive cooking experiences in overseas settings. Thus, many of them are familiar with certain U.S. foods, such as beef, high value seafood, fruits and condiments. Most of the imported ingredients are sourced from suppliers in Guangzhou and Shenzhen.

### **Nanning**

As the center of ASEAN, Nanning has attracted more investment and visitors during the past few years. The city had four five-star hotels and six four-star hotels in 2008. Two more five-star hotels by international hotel groups are set to open in 2008-2009. High season starts in May and extends through February each year.

Fine dining options are on the rise responding to the rapid increase in international visitors and successful mainland travelers coming to Nanning. Therefore good opportunities exist for exporters looking to find emerging markets to promote high quality foods, ingredients, condiments and wines.

However, the distribution network is far from well developed in Nanning. All imported foods are shipped in through Guangdong. A reliable local distribution network still needs to be built.

The competition from other countries is heating up. Thus, U.S. food and wine exporters need to aggressively increase promotional efforts in the HRI sector to gain their share. Leading five-star hotels are good places to start, given their reputation and higher customer range.

## Zhuhai

In the Pearl River Delta, Zhuhai ranked third in tourism development in terms of overnight visitors and foreign currency revenue, after Guangzhou and Shenzhen. The mild weather and nice environment help Zhuhai attract constant visitors year round. Leisure, conference and golfing are the main reasons for visitors to come to Zhuhai. The world famous *Zhuhai Aviation Show* in November attracts thousands of overseas visitors to Zhuhai.

In 2008, Zhuhai had seven five-star hotels and eight four-star hotels, but all by domestic management team. According to industry sources, 60 percent of guests are from domestic, while 25 percent are from Hong Kong and Macau.

Imported ingredients such as cheese, jams, breakfast cereals, ice cream, as well as beef and lamb are best salable item in these hotels. Alaska king crab, Australian lobster can also be found. However, the rich farmland and seashore in Zhuhai produce ample foods, thus, the demand for high-value imported seafood and fresh produce is limited.

Wine consumption is quickly growing in Zhuhai. Imported wines can be found in hotels, restaurants, wine houses and even major supermarkets. The best selling wines price range between US\$21 to US\$44 per bottle. *Cabernet Sauvignon* is one of the favorite varieties.

However, limited U.S. wines are seen in the Zhuhai market, while Australian, French and Chilean are the most known imported wines. Proper wine drinking education and pairing skills are welcomed by local consumers.

## Shantou

The city is a center for business conferences in the region, thus, businessmen are the main customer source for leading hotels. In 2008, Shantou had three five-star hotels and seven four-star hotels.

Chaozhou style restaurants dominate the local HRI sector, especially the high-ends, while foreign style cuisines have gained increasing but still limited presence. A wide range of seafood products, from fish, shellfish, crabs and shrimp to expensive abalone and shark fins, are incorporated in fantastic Chaozhou cuisines in many innovative ways. In addition, poultry, beef and pork are also popular ingredients. U.S. seafood and beef, as senior HRI professionals suggest, are good prospects to wealthy consumers, in line with their enthusiasm for great food.



*Luxury hotels are expanding into the newly emerging city markets  
(Source: ATO Guangzhou)*

As for alcohol consumption, beer and liquor (both domestic and international brands) comprise most of the market, due to aggressive promotions. Wine consumption has just started from a small base, with Chinese brands such as *Great Wall* dominating the market. Imported wines, mostly from Australia, Italy, South Africa and South American countries have gained a limited but increasing presence.

Wines available in the market are sourced from primary dealers in Guangzhou, Shenzhen and even Shanghai. Most wine traders in the market are local entrepreneurs who are secondary distributors.

## Changsha



*Innovative products bring restaurants more business*

*(Source: ATO Guangzhou)*

Changsha is the hub for business, conventional events and tourism in the region. By the end of 2008, the city had nine five-star hotels and 13 four-star hotels managed by both international hotels brands and local management teams. The booming economy and increasing expenditures have attracted more investment in luxury hotels.

Expatriates are solid customers for the hotel operated western style restaurants. Meanwhile, Changsha people never hesitate in trying new things and willing to spend on foods. Despite the province's relatively low average income, the HRI revenue of the province ranks in the nation's top ten, which further proves eagerness for food by Changsha consumers.

Imported cheese, seasoning and condiment, dried fruits and nuts and meat products are found in Changsha. All imported foods to Changsha are sourced from Guangzhou, Shenzhen or even Shanghai. However, many local suppliers can not provide imported products consistently.

Beef steak is the most popular entree when Changsha customers want Western style of food. The most popular beef cuts are rib eye, sirloin and T-bone steak. Wine consumption is still at its earlier stage in Changsha establishes, proper education and brand recognition are keys for long-run success.

## Quanzhou

The busy export business brings thousands of visitors to Quanzhou and they form the major customer source for four to five-star hotels in town. In 2008, Quanzhou had three five-star hotels and nine four-star hotels, all by local management.

Business and family banquets tend to choose restaurants in leading hotels for status. A high budget allows hotels to use top quality foods in meals, such as silver cod, fra gras, Kobi beef, abalone, sea cucumber and live lobster. Some hotels also serve U.S. beef, which they source from Guangzhou.

Hotels in Quanzhou source food supplies either from local suppliers or *Metro*. Local suppliers usually get imported products from importers based in Guangzhou, Xiamen and Shanghai.



Imported beef, seafood, cheese, seasoning, olive oil, breakfast cereals, frozen fries and different vinegars are widely used in high-end hotels. Inconsistent supply and infringements of imported foods are the biggest concern in adopting more.

Menu promotions will be a good way to promote American food products, and better target peak buying seasons in March, May, July and September. Chef training is needed to nurture the market.

For more information regarding the emerging city markets, please see the related GAIN reports prepared by ATO Guangzhou.

### Restaurants

The restaurant sector in South China enjoyed solid growth over the past few years. Guangdong's 2007 sales revenues were recorded at US\$4.47 billion (RMB30.38 billion), up twenty percent from the previous year. Other provinces in Southern China totaled US\$1.77 billion (RMB12.02 billion) in 2007.

Cantonese cuisine enjoys world renowned reputation. In addition to their much loved traditional fare, Cantonese are also known to appreciate different tastes. They are curious about other food styles and on occasion have been cast as 'eating everything.' One will find different styles of foods from all over the world in Guangzhou, the world's food heaven.

In addition to good taste, innovative dishes help restaurants maintain and attract more customers. This encourages restaurateurs to seek-out new trends and offerings to win interest and remain competitive. This, of course, provides a good avenue for U.S producers to satisfy this strong demand.

Towards this goal, distributors need to give restaurant chefs new recipes and ideal selling points to support efforts to include U.S. produce on their menus. Consistent supply and good quality are keys to maintain market share.



*Fusion cooking feature high quality U.S. products*

*(Source: ATO Guangzhou)*



South China Restaurant Industry Revenues			
Province	Revenues in 2006	Revenues in 2007	Change
Guangdong	US\$3 billion (RMB22 billion)	US\$ 4.47 billion (RMB30.38 billion)	38.09%
Fujian	US\$575 million (RMB4.20 billion)	US\$ 813.24 million (RMB 5.53 billion)	31.67%
Hunan	US\$534.2 million (RMB3.90 billion)	US\$ 698.53 million (RMB 4.75 billion)	21.79%
Guangxi	US\$136 million (RMB992.90 million)	US\$ 177.94 million (RMB 1.21 billion)	21.87%
Hainan	US\$72.2 million (RMB 526.90 million)	US\$ 77.48 million (RMB 526.86 million)	0.00%

Remarks: All restaurants surveyed have annual sales greater than US\$294,000 (RMB2 million)

(Source: 2008 Statistics Yearbook of related provinces)

There is no doubt that food safety is one of the hottest topics in China. Consumers in South China are more concerned about the quality of local products and willing to pay a premium for finer imported items. To meet this shift in demand, more restaurants offer dishes with imported ingredients which is believed can add nutrition, flavor and extra value.

Increasingly Western-style restaurant chains continue to strengthen their presence throughout South China. Most appear to expand operations either through direct investment or franchising. To ensure quality standards, most have set up centralized food processing centers to maintain standard recipes. Pork, poultry, seafood, almond, cheese and other seasoning products from the U.S. are regularly promoted on their menus as a key selling point to local consumers.

Fast food giants such as *KFC* and *McDonald's* are expanding rapidly into the fast emerging second and third tier cities. Sales revenues for these two chains in Guangdong are reputedly the highest in China.

While serving the regular menu items found in their outlets all over the world, one trend that is attracting favorable local response is inclusion of new recipes developed specifically for local palates. For example, KFC introduced egg drop soup and an Alaska black cod burger, while McDonald's launched a Chinese spicy beef burger.

Consistent supply is the key for imported ingredients to gain a steady foothold in the restaurant business. One interviewed leading hotel manager said once the dish is printed on menu, they must be served. Thus, consistent supply is a must to meet criteria for purchase decisions of imported products.

### Growing Demand for Wine

Along with food, wine consumption is steadily growing in South China. Middle to higher-priced imported wines have found their niche in upper end restaurants and hotels, while lower-priced wines are readily available in international style retail outlets and wine houses.



*Wine drinking is gaining popularity among wealthy consumers in South China*

(Source: ATO Guangzhou)

According to industry sources, wines priced at US\$40 (RMB300) per bottle enjoy strong demand in restaurants in developed coastal cities, such as Guangzhou and Shenzhen while in the emerging markets the best seller range from US\$9-15 (RMB60-100). French, Australian and Chilean producers have taken the lead in promoting their brands.

Major wine importers regularly organize wine tasting events and connoisseur dinners accompanied with fine wine selections to promote their products to upwardly mobile customers. On occasion wine makers fly in to promote their products. However, to date American wine producers have maintained a low profile in South China.

### Institutional Food Service

The expatriate community is the main market for high-end western style catering services. The number of expatriates in South China has grown and is fast emerging as a market opportunity for imported food and beverage producers, particularly cheese, meat products, seasonings and soft drinks.

Local catering companies remain steadfast about producing low cost "lunch box" products. Today more businesses arrange with catering companies to supply lunch to their staff as benefit of employment.

Two distinct categories are available: "white-collar lunch boxes" priced at US\$1.50 to US\$4.00 per box, and "blue-collar lunch boxes" ranging from US\$.50 to US\$1.50 per box. No doubt, using expensive imported ingredients is not a practical option.



*Special take out dish for Chinese New Year*

(Source: ATO Guangzhou)

One emerging trend is the demand for "off-site catering". Most leading hotels and restaurants offer this service. For example for business meetings, special events or private party such catering services are viewed positively for both status recognition and convenience.

During holiday seasons, such as Chinese New Year celebrations, demand rises for catering. One leading chain in Guangzhou offered spring festival set take out menus ranging from US\$57-204 (RMB388-1,388), which recorded double the sales in this year. According to the chain manager, consumers prefer the convenience and tasty dishes and like to include expensive ingredients, such as sea cucumber, scallop, abalone, oyster and other seafood.

## Conclusion

Competition in Southern China's HRI sector is fierce, but market opportunities exist for experienced operators to establish their brand in one of the fastest growing economies of the world. Out of concerns for the economic slowdown, many consumers are tightening their budgets for dining and travel. To survive, the HRI sector needs to offer better quality and innovative products in addition to competitive price.

## Appendix

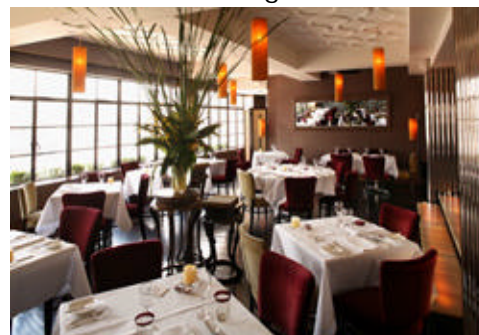
### **SWOT Analysis of American Products in the South China HRI Sector**

<b>SWOT</b>	<b>South China HRI Industry</b>
Strengths	<ul style="list-style-type: none"> <li>- American products' reputation for high quality, safety and nutrition</li> <li>- Health consciousness and rising income stimulate demand for imported food products</li> <li>- High GDP in Mainland China and strong purchasing power</li> <li>- Major hub for imports</li> <li>- Good distribution system in major cities</li> </ul>
Weaknesses	<ul style="list-style-type: none"> <li>- High prices</li> <li>- Not enough awareness of American products</li> <li>- Lack of knowledge on how to handle imported ingredients</li> <li>- Lack of education and training in the HRI sector</li> </ul>
Opportunities	<ul style="list-style-type: none"> <li>- Decline of import duties</li> <li>- Food safety and nutritional concerns by local consumers</li> <li>- Sustainable growth in the HRI sector</li> <li>- Some of the most sophisticated restaurants are being operated in the region by highly skilled chefs open to new ideas</li> <li>- International reknown 5-star hotel chains operate locally</li> <li>- Appreciation of Chinese currency which make U.S. products more competitive</li> </ul>
Threats	<ul style="list-style-type: none"> <li>- Unreliable distribution systems and cold chains in newly emerging cities</li> <li>- Increasing competition from domestic and foreign suppliers</li> <li>- Consumers don't know how to identify authentic American products</li> <li>- Non-tariff and technical barriers</li> </ul>

<b>U.S. products in South China HRI Sector</b>	<b>U.S. products with good potential</b>	<b>Available competitor products</b>
Beef, pork, seafood products, frozen potato products, almonds, cheese, sweet corn, poultry products, fruits, sauces and seasoning products, wines and liquor	Cheese, red wine, high-value seafood products, beef, sweet corn, seasoning products, sauces, almonds, olive oil, frozen potato products, red wine	Cheese, beef, seasoning products, olive oil, sun dried tomato, sausage, fruits, poultry products, frozen potato product, white wine, liquor

#### 4. ATO Shanghai Market Summary

Shanghai is China's largest city, its leading commercial and financial center and the home of its largest port. With an official population of 18 million and a 2008 GDP of \$197 billion, per capita GDP reached \$10,529, significantly higher than the rest of China and 9.7% higher than the previous year, although some indices of revenue turned negative due to the impact of the global economic crisis which began in the second half of 2008. Shanghai's economy is becoming increasingly focused on finance and services, as rising prices drive manufacturing further beyond the city limits. International companies continue to find Shanghai attractive however. Shanghai is an aggressively cosmopolitan city, which derives much of its strong sense of identity from its knowledge and adoption of international brands and fashions. Hence, while Shanghai has a very distinct food culture of its own, the Shanghaiese are open to new tastes and new products, making it an excellent market for imported food and food ingredients. As with the rest of China, food plays a central role in all aspects of Shanghai life. Business, networking, celebrations and friendly get-togethers are invariably centered around a meal. Food is widely given as gifts, particularly during festival periods, and this has become an especially important niche market. Affluent local residents are more than willing to pay for quality products, provided they can be persuaded the product is truly special.



High per capita incomes and a mixed food culture have made Shanghai's restaurant sector a vital part of the city's economy. In 2008, catering industry revenues reached over \$ 9.8 billion, a 20 % increase from 2007, amounting to 14.8 % of the overall commodity retail sales in the city according to statistics provided by the Shanghai Restaurant Industry Association (SRIA). Due to the global economic recession which has impacted the local restaurant industry since September of last year, the growth trend in restaurant sales has shown signs of slowing down, confirmed by figures from the SRIA which indicate that the growth rate in the second half of 2008 was down 5 percentage points compared with the first half of the year.

Year	GDP RMB (Billion)	Per Capita GDP RMB	Per Capita Disposable Income RMB	Per Capita Expenditure on Food RMB
2008	1,369.81	73,124	26,675	*
2007	1,218.88	66,367	23,623	6,125
2006	1,036.63	57,695	20,668	5,249
2005	916.41	51,529	18,645	4,940
2004	807.28	46,338	16,683	4,593

Source: Shanghai Statistical Year Book, the municipal government's press conference and SRIA. \* will be available in June 2009.



### Restaurants

Not surprisingly, Shanghai's sustained economic growth in 2008 and rapid increase in incomes played a major role in boosting the local restaurant industry. According to a recent survey by the SRIA, the total sales revenue generated by 22 key restaurant groups in Shanghai reached RMB 3.6 billion in 2008, an increase of 13% over the previous year. As much as 14.8% of total Shanghai retail sales of consumer

goods came from the sales revenue of the restaurant industry. Shanghai remains at the top of the list for total restaurant sales revenue in China's major cities. Shanghainese per capita spending on dining out reached RMB 2,068 in 2008, an increase of 20% over the previous year. However, the growth rate in 2008 sales revenue slowed by 10 percentage points compared with the growth rate in 2007 owing in particular to the global economic downturn.

Year	Total Industry Sales Revenue		Per Capita Disposable Income		Per Capita Expenditure on Dining Out
	RMB (Billion)	Growth Rate (%)	RMB	Growth Rate (%)	RMB
2008	66.954	20.1	26,690	13	2,068
2007	55.646	23.1	23,623	14.3	1,722
2006	45.216	29.1	20,668	10.8	1,482
2005	35.031	16.7	18,645	11.7	1,331
2004	30.017	39.7	16,683	12.2	1,183

Source: Shanghai Restaurant Industry Association, Shanghai Statistical Year Book and the municipal government's press conference.

One major characteristic of the Shanghai restaurant industry is the consumption patterns during the holiday and festival seasons. According to the SRIA, the major Chinese restaurant groups reported 18% growth rate during the major Chinese holidays/festivals, such as the traditional Chinese Lunar New Year as well as the May 1st and October 1st holidays. Chinese consider the Chinese New Year's Eve dinner the most important meal of the year, as it inculcates family cohesion by providing an opportunity for family members to gather and celebrate the New Year together. As work becomes more hectic, more and more families choose to have their reunion dinner in restaurants. Many major Shanghai restaurants are fully booked during this time. Some restaurants even have to impose time limits per meal in order to turn the table around as many times as possible that night.

Most of the medium to high-end Shanghai restaurants are potential users of high-end imported food ingredients. Some restaurants already feature imported U.S. ingredients in their recipes as they develop innovative products/dishes to appeal to the more adventurous consumers willing to try new products. Thanks to the continuous marketing efforts by ATO, USDA cooperators and distributors, U.S. food ingredients and beverage products such as pork, seafood, poultry, frozen potato products, dry fruits and nuts, seasoning products, wine and beer are becoming more and more popular as ingredients in both Chinese and western style dishes, and on the wine and beverage lists of popular local restaurants and bars.



Shanghai's many different types and styles of restaurants provide a wide experience of food entertainment venues, including fine dining, casual dining, Chinese and western fast food restaurants. Based on discussions with SRIA, there are over 1,700 western and other foreign style restaurants in Shanghai offering more than 30 different cuisines to local consumers as well as the approximate 500,000 expatriates living and working in Shanghai. The increase in disposable income has also led many Shanghainese to indulge in western and fusion style cuisines. High-end restaurants, such as Jean Georges, New Heights and Sens & Bund, scattered around the famous Bund area in Shanghai, are often busy despite the steep prices of as high as RMB 1,000 per person. To cater to the average consumer, there are also a huge number of western restaurants offering affordable meal packages at RMB 120 per person.

### ***Trends***

The Shanghai restaurant industry is expected to maintain its steady momentum based on the growing economic indicators, an increasing number of visitors, high disposable income and strong demand for dining out despite the current worldwide economic crisis. Furthermore, international venture capitalists have taken a strong interest in privately-owned chain restaurants, sparking a strong trend in franchising across China.

An important trend in Shanghai's restaurant sector is the emergence of middle and high-end restaurant chains and clubs. Local brands like Xinhualou, Hongziji, Yuyuan Xiaonanguo, Jade Garden and Fengshouri, each with about a 1.5% market share, contribute more than 30% of the total Shanghai's dining out sale revenue. The combination of chain-store buying power, high quality standards and good management makes these emerging chains strong candidates for high value imported food ingredients. While the rise of formal dining restaurants continues to slow somewhat, medium and small size theme restaurants with a river-view, plus casual, specialty and private clubs and restaurants with a stylish ambience and convenient location, continued to achieve impressive sales results in 2008.

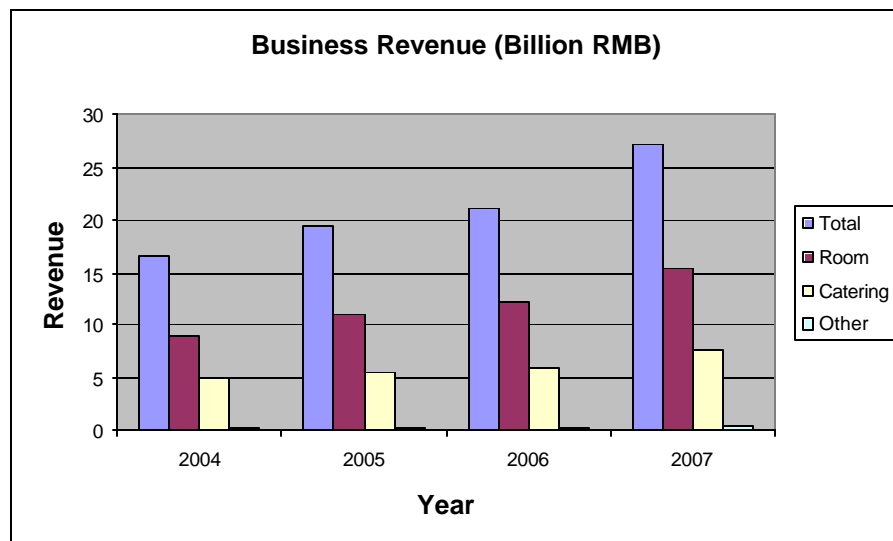
However, the Shanghai restaurant industry has not been immune to the impact of on-going global economic crisis which began to be felt locally in the latter half of 2008. An SRIA survey shows that since September 2008, the restaurant enterprises in Shanghai have experienced a slowdown both in terms of sales revenue and profit, currently 15-20% and 5-8% respectively. Those who have suffered most are the high end restaurants catering receptions and private celebrations with prices above 1,800 RMB per head. Although the number of guests returned somewhat to normal during the January 1 holidays, per head consumption dropped 20-25% over the past six months. Experts assume that the industry may face further difficulties in the months following the Chinese Lunar New Year (last week of January) and before the May 1 Labor Day in 2009. Growth in 2009 may be even flat among high-end hotel restaurants owing to the economic recession and rising operational costs (which was reported to rise 15% in the first half of 2008). Formal restaurants will continue to find ways to put medium priced, healthy and less oily dishes on their menus to replace traditional foods with expensive ingredients like shark's fin or abalone which were formerly



viewed as luxuries for high-end business receptions.



## Hotels



Source: *Shanghai Statistical Yearbook*

In 2007, hotel catering revenue reached 7.7 billion RMB (\$1,124 million), which experts believe was mostly contributed by star-rated hotels. It is the norm in Shanghai for four and five star hotels to allot \$16/person (usually already included in the room tariffs) to the kitchen to enable the chef to include imported food ingredients in the breakfast buffet menu. Judging from the four and five star hotels' average occupancy and room rate (which stood at 63.47% and RMB 648 (\$94), and 68.2%, RMB 1,336 (\$195), respectively, for 2007), breakfast revenue formed a very stable source of revenue. It is therefore not surprising that four and five star hotels remain the core markets for new-to-market and high-end imported food ingredients. Though there is no data available to substantiate our findings on the demand for and consumption of domestic versus imported food products by the hotel industry, major imported food distributors supplying hotels in Shanghai report an annual growth of 20% in its hotel catering business sector over the past four years.

Shanghai's hotel sector is extremely well-developed, and continues to expand under the pressure of growing demand. This steady growth can be attributed to the annual influx of more than 9 million domestic and international visitors to Shanghai attending commercial events such as trade shows, conferences, sports events and business trips, an increase of about 2.8 % from the previous year. The Shanghai municipal government also works hard to promote the city by working with international organizations to host events, meetings and conferences, and at the same time appeal to individual and group tourists. According to the Shanghai government, hosting the World Expo in 2010 will generate additional 7 billion visits throughout the five-month long event period. As a result, a number of new hotel construction projects, along with the construction of several new rail transportation lines are in full swing across the city.

Industry sources estimate there are more than 3,800 hotels and inns in Shanghai. They can be categorized based on the services that they provide into star-rated hotels or social hotels. While star-rated hotels provide a complete range of premium services from rooms, food and beverages, health clubs to meeting facilities, social hotels provide only the basic minimum accommodation facilities (which depending on location, may include simple breakfast services).

Star Rated Hotels in Shanghai				
Year	Total	Five Star	Four Star	Others
2007	320	32	47	241
2006	317	26	43	248
2005	351	25	41	285
2004	359	24	37	279

*\*Source: Shanghai Statistical Yearbook*

At the end of 2007, Shanghai had 320 star-rated hotels, of which 79 were rated four stars or higher, an increase of six 5-star and four 4-star hotels over the previous year. Expansion of highly rated hotels is likely to continue or accelerate, particularly in advance of the 2010 Shanghai World Expo. A number of hotels rated three stars or below which were closed or partially opened to business for reconstruction or expansion reopened in 2008. High star rated hotels have become more attractive even for domestic visitors. Total business revenues for Shanghai's hotel industry hit a high of 27.1 billion RMB (\$4 billion) in 2007, an increase of 28% from 2006, while total profits reached RMB 3.2 billion. Official statistics show that the small number of star-rated hotels, amounting to 320 in 2007, contributed 60% of the total industry's business revenue, equaling 16 billion RMB (\$2.3 billion). In late 2008, however, business declined dramatically since the Olympic Games in Beijing ended in August. Some five-four star hotels reported that they merely managed only a 50% occupancy rate, but some fell even lower in the last few months of 2008. Owing to the global financial downturn, many events scheduled at hotels for annual meetings, networking events and celebrations were cancelled or scaled down.

Shanghai Star-Rated Hotel (SRH) Statistics			
Year	No. of SRH	Business Revenues (Billion RMB)	Percentage of Total Industry Revenue
2007	320	16	59
2006	317	15.4	73
2005	351	15.3	78
2004	359	14.0	84

*\*Source: Shanghai Statistical Yearbook*

### **Trends**

With the approach of the 2010 Shanghai Expo, Shanghai is witnessing a stream of investments in the construction of both high-end premium hotels and low-end budget chain inns. The Shanghai World Expo Committee speculated that around 60 premier hotels to be constructed by 2010 will help accommodate an additional 3 million guests. The budget chains have also seen tremendous growth since their launch in China a few years ago. At the projected high annual growth rate for the next few years, it is inevitable that more new players will attempt to enter the budget hotel industry. Local experts predict that the Shanghai hotel business will witness another wave of high growth by 2010 when China's economy is expected to recover from the current financial recession and the World Expo will be taking place in the city.

### **Institutional Food Service**

Institutional food service in Shanghai is not as well developed as either the restaurant or hotel sectors, although there is a thriving industry that provides “lunch boxes” to offices, schools, companies, kiosks and C-stores. The target price for these meals is between \$1.50-\$4.00 each, making them a poor candidate for high value imported products. According to the Shanghai Restaurant Industry Association, based on the calculation of an average price of RMB 15 (\$2.20) and an average six million people consuming lunch boxes on working days in Shanghai, the catering market can be estimated at around RMB 27 billion. A potential bright light for imported products is at the universities, hospitals, exhibition centers, government and academic institutions, and large companies whose canteens are managed and serviced on a contractual basis by certified catering companies where meals tend to emphasize quality, nutrition and wholesomeness. Catering service companies like Shanghai Lanchao and Shanghai Luquan have well-trained management and chef teams as well as professional material-sourcing and distribution channels to control food safety, quality and cost. Their Shanghai based business has gradually penetrated to neighboring cities throughout the Yangtze River Delta region. Airline catering rounds out the institutional food sector, but again the focus in that segment tends to be on bottom-line cost. Domestic in-flight catering only provides imported dry fruits and nuts in small snack food packs to the passengers. The institutional food sector will remain price-driven with extremely low margins in the foreseeable future.

## **SECTION II: MARKET ENTRY**

### **A. Market Structure**

#### **1. Target Population**

Looking ahead, it is estimated that by 2030, more than 1 billion Chinese will live in cities, with these urban consumers will account for approximately 90 percent of total national consumption. In the meantime, rising disposable incomes, particularly among white-collar workers, means this segment can now afford to try imported food and beverages on a regular basis. Increasingly, it is fashionable to sample international cuisine and wine, and many urban Chinese have both the desire and means to dine out regularly in upscale restaurants and bars. Chinese consumers actively pursue information through lifestyle media, TV and newspapers about imported food and food products, often seeking opportunities for new culinary experiences beyond traditional Chinese cuisine.

Increased consumer and media consciousness of nutrition, food safety, and health is also driving the market for food imports. Obesity continues as a public health issue in China, especially child obesity, with demand for low-fat, calorie conscious and healthy options rising. Women are increasingly interested in food and beverages that acclaim to improve hair and skin health, and seniors seek vitamin-fortified products with real and perceived health benefits. Functional foods with ingredients as such omega 3 fatty acids, anti-oxidants, and high-fiber have also found a growing market in urban China.

Major cities like Beijing, Shanghai, Guangzhou and Chengdu have benefited greatly from economic reform and foreign investment. The potential for growth in food imports also appears to be particularly promising in Emerging City Markets (ECMs), where new development effort and growing integration with the global economy is driving demand for new products. Some of these Chinese cities include Tianjin, Qingdao in the north; Suzhou, Wuxi and Hangzhou along the Yangtze River, and Shenzhen, Dongguan, Zhuhai in the southern Pearl River Delta.

## 2. Distribution and Cold Chain Infrastructure

Less than a decade ago most imported products flowing into mainland China arrived via Hong Kong. Transit times by truck to Beijing take four days from Hong Kong and the trek by truck from Shanghai to China's far western provinces six days. With economic and policy liberalization as well as infrastructure improvements, increasing levels of 'direct imports' enter China via Shanghai, Tianjin, Qingdao and other ports, improving transport times and increasing market access for and information about the diverse variety of food and agricultural products consumed in China.

Distribution channels are improving in major markets such as Beijing, Shanghai, Guangzhou and Chengdu, according to food service industry insiders. Improved expressways, ports and cold chain infrastructure continue to expedite transportation and delivery. However, outside major metropolitan areas, cold chain distribution is still often unreliable. Purchasing managers at major hotels in some Emerging City Markets (ECMs) resort to transporting imported products primarily by air, and even then, complications are not uncommon. "We commit to a menu, but we can't get consistent product supplies, and if we switch to domestic products, quality is far from adequate. On another level, counterfeit products are also a problem for imported food, beverage and ingredients which hurt our reputation in the long run," says one restaurateur. Increasing ECM demand requires expanded warehousing, improved importer-local agent networks to deliver quality imported food products.

China's cold chain and logistic bottlenecks affect the food service industry. A large Western quick service operator - Yum! Brands recently opened a 12,000 square meter distribution centre in South China to provide cold chain distribution solutions for more than 400 stores in Guangzhou, and surrounding cities. In total, Yum! Now owns 16 distribution centers in China to serve 2,000 KFC, Taco Bell and Pizza Hut outlets.

Cash flow presents difficulties for many distributors: buyers, especially large-scale customers like hotels, usually with a pay period of 45-90 days post delivery. Payment for food imports often takes place 30 days after invoicing, usually upon shipment. As distributors develop a positive relationship, fewer suppliers require full payment in advance, but even under the best of circumstances, top distributors are still required to make deposits that can average 30 percent or more on some products such as meat.

Despite overland infrastructure improvements, distributors say air continues to make up around 10 percent of their import cost by volume and more than twice that amount in value terms. Airfreight shipments of meat and dairy product as well as some fruit and vegetable air shipments are routine. Some traders report airborne imports face fewer customs and quarantine difficulties compared to imports by sea. Complex quarantine and customs procedures often cause import delays on an all-too-regular basis although distributors report the port of entry is a large variable in the frequency and duration of delays.

### Gray Channel Supplies

The Hong Kong 'gray channel' is still a primary supply route for products destined for the Pearl River Delta and southwestern China, including Sichuan, Yunnan, Hunan provinces, and Chongqing. Most northern distributors have eliminated reliance on the gray channel or reduced such imports to less than 20 percent of total volume. Gray channel goods are handled by Hong Kong agents who work with Chinese agents, often based on family connections, across the border in Guangdong Province. Cargo is under-invoiced to reduce tariffs. In addition, some distributors say, it is easier and less expensive to source low-volume shipments from Hong Kong, rather than taking the risk of landing full containers in more northern ports.

However, WTO tariff reductions and a general loosening of controls have diminished the advantages of under-invoicing, as the central government continues to crack down on customs tariff and tax avoidance. In addition, the growth in imported food is moving North and East, away from Guangzhou, since the cost of transportation and quality issues can eat into the perceived savings of gray channel product shipments.

### Direct Imports

Rapid growth, tariff reductions and infrastructure improvements have increased food import volumes in Dalian, Tianjin, Qingdao, Shanghai, and Xiamen. All of these ports now have modern docks, warehouses and container handling. Customs procedures have become more transparent as standard protocols for individual products evolve port-by-port. However, arbitrary treatment and policy changes still impede shipments unexpectedly, and importers complain inspectors are inconsistent: "They will block something for slight variations in bills of landing or other documents," says one importer.

Major distribution options include:

- Full-service distributors.
- Third-party/ fourth-party Logistics. China has liberalized its distribution industry under WTO rules, and a small group of foreign-managed companies has developed in ports and free trade zones offering customs clearance, foreign exchange conversion, bonded warehousing and shipment. However, most do not specialize in the food business, so distributors or sales agents still need to sell, promote, and navigate many bureaucratic hoops such as licensing, labeling, and perhaps most importantly get paid from customers.
- Direct sales to end-users. This is limited to high volume customers like fast food and large hotel chains. Post suggests having local agents handle the paperwork and licensing issues to relieve the unexpected hassles, which can cause delays and risk the loss of whole containers of goods.
- US consolidators fill orders for China-based distributors, and also fill direct orders for restaurants and hotels, so you still need to make sales in China. US consolidator efficiency is considered a major advantage for US exporters.
- Hong Kong distributors, who frequently make use of the gray channel. Many have a large network of offices or affiliates inside China, but basically provide the equivalent of 3<sup>rd</sup> party logistics services. The supplier still remains responsible for promotion, training and developing a market.
- Cash 'n Carry Outlets, such as Metro and Wal-Mart that target commercial customers like restaurateurs for purchase of bulk supplies – able to reach the restaurant food service trade directly.

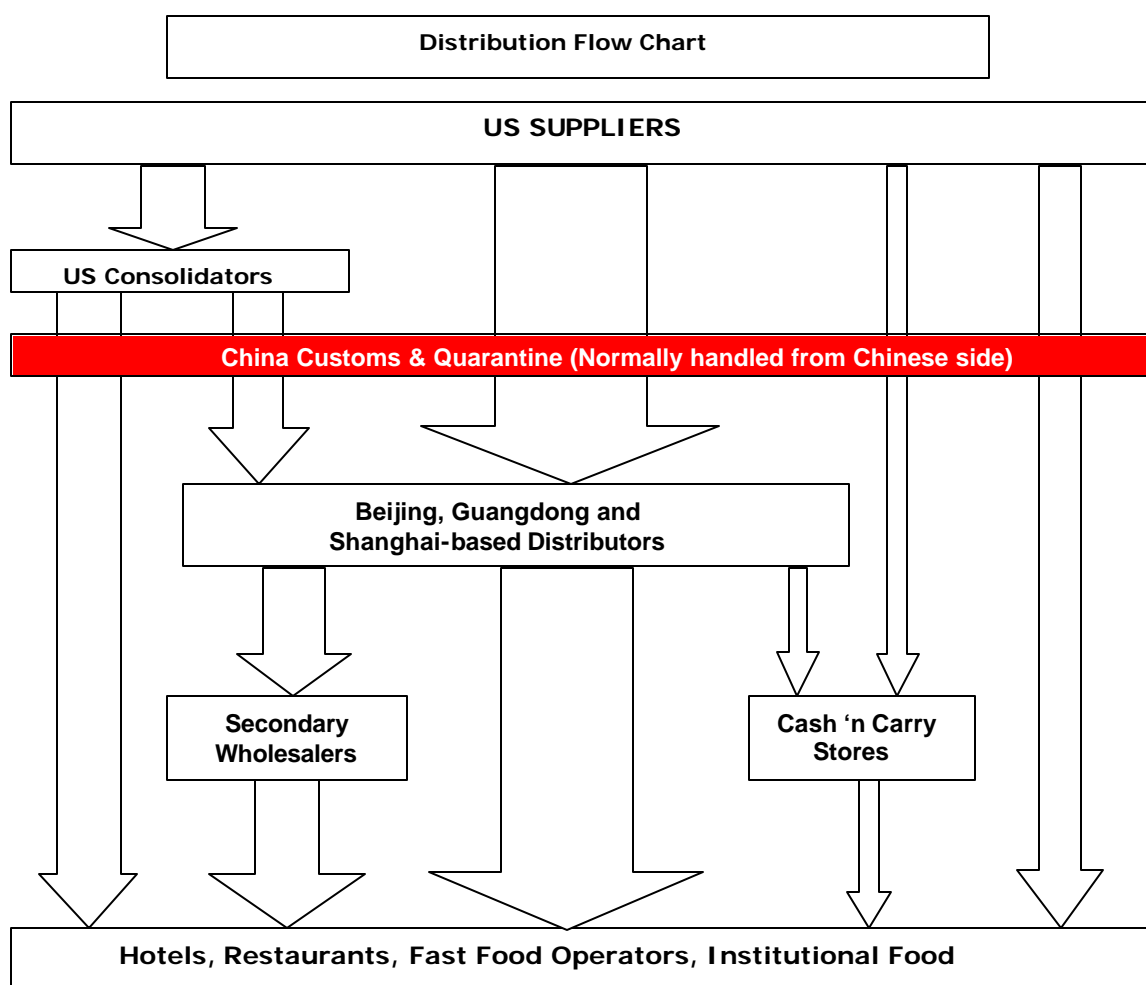
## B. Entry Strategy

### 1. Overview

Entering China's market can be incredibly rewarding, but it requires hard work: selling and distributing your product requires face-to-face contact, a special effort to educate the entire value chain, and attention to the details of distribution. Even good distributors in China lack marketing experience and it can also be difficult to get them to focus on promoting your product among the hundreds or even thousands they may carry. Some suppliers conduct marketing on parallel tracks, working with their local distributors but also engaging a small independent marketing and sales force that reports directly to them. Entry strategy should focus on the elements below:

- **Marketing, Sales and Education:** Introducing your product and persuading them to use it is only the beginning. Chinese distributors and chefs are often interested in imported products, but usually lack proper handling and preparation knowledge. This can extend even to very basic products, like condensed canned soup or ingredients, etc. and strong educational effort is required.
- **Selecting a Distribution Channel:** At the same time, it is also important to make sure that your distribution channel can provide a consistent supply for your customers. Often, the first question buyers ask about a new product is, "Can I order it now?" This can be and often is a bit of a chicken-and-egg syndrome for a new supplier in the China market, but an important consideration nonetheless.

## 2. Marketing, Sales and Education



If there is one mantra that emerges from extensive discussions with HRI industry insiders, it is that the Chinese market needs to be educated from A-to-Z for most imported products. These means showing distributors how to handle and sell the product; developing recipes and demonstrating to chefs and food service staff how to use, prepare and serve it;



launching promotional events to entice consumers with the resulting menu, and last but not least, persuasive articulation of why the product use makes commercial and economic sense in local terms.

Distributors will not make the effort alone, but are willing to work together with suppliers to make a product successful. Several full-service distributors say they focus on building worthwhile brands, which requires building relationships with buyers, providing technical support and training, making joint calls and hosting promotions. "You have to make people truly understand and how to use the product," says one of the major north China importers.

Successful suppliers have developed a number of strategies to educate the market. On sales calls, they go fully prepared to demonstrate their product. They develop recipes that incorporate the product into Chinese cuisine, illustrating broader versatility. Some bring in chefs and set up a theme promotion at a local hotel for several weeks, often giving intensive and highly focused workshops for local chefs.

Catalogues, recipes and handling instructions are best provided in Chinese. This is particularly important with Chinese-operated hotels and restaurants, but even five-star hotels with western-trained chefs often have staff that have difficulty understanding labels and directions unless printed fully and clearly in Chinese.

Restaurateurs cite national or ethnic food fairs and promotions as an effective way to reach the ultimate consumer. Many restaurants look for opportunities to do special promotions, capturing customers on the lookout for a new dining experience.

The United States Department of Agriculture (USDA) has several export programs that can help support promotion and training. As well, a number of US states and even some cities have offices in China; many cooperate with the US Agricultural Trade Offices in Beijing, Chengdu, Guangzhou, and Shanghai. The State Regional Trade Groups and other USDA market development cooperators also conduct a variety of effective educational and promotional market development programs and/or maintain representative offices in China.

### **3. Establishing the Supply Channel**

The most important advice for U.S. suppliers before entering the China market is to partner with a good distributor. Like many Asian countries, business culture is heavily dependent on personal relationships in China. Face-to-face contact plays a key role in ensuring reliability in situations where legal structure and contract enforcement are vague. Selecting suitable distributors requires effort and cooperation on both sides. US suppliers should work to develop an understanding of target markets within China and clearly define their market expectations for their local distributor.

For their part, the distributor should be able to handle customs, quarantine and any licensing procedures. Some distributors do their own paperwork, while others use import agents. These procedures involve so many requirements and 'red tape' that few suppliers or end-users, including Chinese state-owned companies, try to do it on their own. Apart from the licenses and permits, hygiene certificates from the US government are also required for food products. In addition, Chinese import permits, hygiene and quarantine inspection certificates are expected on product entry. Proper labels in Chinese may be required, but stick-on labels are acceptable as long as they have already been applied to the product upon entry. Your distributor should have the ability to facilitate everything mentioned above. Plan ahead and work with distributors to understand the duration of each stage of the process .

It is crucial your importer or distributor is able to make payments in hard currency, or you will have trouble collecting payment. The government has considered plans to make the

Chinese Yuan (CNY), also called Renminbi (RMB), into a fully convertible currency, but it may be a number of years before such plans become a reality. Currently, Chinese companies need special licenses to change RMB into US Dollars. Also, RMB exchange rates began to fluctuate and continue to appreciate against the US Dollar in 2009 – it is important to establish an agreed upon currency and exchange rate system or policy for any payments or costs.

Suppliers of perishable products need to be alert to the cold chain procedure of distributors, because infrastructure is uneven. Even in cities like Beijing, Shanghai and Guangzhou, many buyers use infrared guns and in-transit thermometers to check for tampering-temperature variations. “You have to be a policeman; otherwise, they will cheat you.” says one food & beverage director in Beijing.

#### **4. Protect Your Intellectual Property Rights**

FAS China established an IPR Office in 2006 to address IPR and Labeling issues related to US agricultural and food products in China. The aim of the Office is to provide direct assistance to U.S. industry and commodity associations and businesses, in their effort to secure registration, as well as to prevent and/or address IPR infringement with appropriate market and legal enforcement remedies.

Although China continues to make efforts to strengthen its legal framework and amend its intellectual property rights (IPR) laws and regulations to comply with WTO obligations, U.S. agriculture and food products still face serious IPR infringement problems. Some examples of IPR infringement issues include:

- “Stickering” and labeling domestic and third-country products with U.S. identification such as California Table Grapes, California Pistachios, U.S. Wheat Flour, Washington Apples, Wisconsin Ginseng, etc., is widespread.
- False branding and packaging of domestic and third-country products with U.S. identification such as Sunkist® Citrus, Sun-Maid® Raisins, and wines from Napa Valley, California.
- Counterfeiting or mixing of domestic or third country products with U.S. food and beverages including poultry, beef and pork.
- Unauthorized sale-use of U.S. PVP protected plant materials and germplasm.

The most effective deterrent to piracy is to properly register patents, trademarks, plant varieties, geographical indicators, food labels, and other such IPR at home, in China, and third-country markets. Below are some of suggested resources to use. All of them contain information on China’s patent, trademark legislation and enforcement, as well as Plant Variety Protection laws (PVP).

- Review FAS China’s website: [www.usdachina.org](http://www.usdachina.org), find ‘IPR in CHINA/ Introduction to Trademark Registration in China’, the IPR Manual produced in 2007 by FAS IPR Office as well as other related information.
- Online reports: CH7027, CH7030, CH7046, CH7023, CH7028, CH7035, CH2049 and CH4059, available from: <http://www.fas.usda.gov/scripts/AttacheRep/default.asp>
- The U.S. Embassy’s China IPR toolkit: [http://beijing.usembassy-china.org.cn/protecting\\_ipr.html](http://beijing.usembassy-china.org.cn/protecting_ipr.html)

The FAS China IPR Office is located in the Agricultural Trade Office (ATO) Beijing. For additional information, please email [chinaipr@fas.usda.gov](mailto:chinaipr@fas.usda.gov).

## 5. Entry Tips

Experienced distributors and buyers offer the following advice for those who wish to enter the China market:

- Take time to study the market. Understand the exporting/importing process from start to finish. Partner with a reliable and capable distributor to execute all necessary importing documents and licenses.
- Having a great product is only the beginning. It is critical to understand the target market and prospective clients before you enter the market. If an international hotel, restaurant, fast food chain or air caterer is an existing client in the U.S., try to use that as an entrée to the China branch.
- Be sure the products you carry are unique – if there is a similar domestic substitute or established foreign competitor, it may be difficult to compete on price/quality. An alternative strategy may be to enter the market by exploring geographic market segments not yet covered by the competition.
- Participate in USDA endorsed trade shows. Many suppliers get excellent market information by scheduling an initial visit to coincide with one of the many large international exhibitions held here in China, such as SIAL China, Food Ingredients China, Food & Hotel China (FHC), or China Fisheries and Seafood Expo. ATOs in Beijing, Chengdu, Guangzhou and Shanghai can all provide contact details for show organizers upon request.
- Be financially prepared. Consider all possible costs, such as: license, customs handling, promotion, education and training, freight, tariffs and VAT.
- Unless you are supplying one of the fast food chains or a hotel group, only selected products may ship large volumes. Most likely you won't be able to start with full container loads so consider waiving order minimums during the market entry phase.
- Different regions in China have unique and diverse dietary habits and tastes in food, just as they do in the US. Always start in one region and conduct market tests before entering another. You may need to modify a product to make it conform to regional tastes and purchasing habits.
- Don't be too ambitious. Expand your business only after full confidence in operation in one location. One of the most common mistakes made in the China market is overly ambitious expansion without a solid foundation and loyal customers.
- Work to incorporate locally celebrated holidays, festivals and customs: Chinese New Year (Spring Festival), Mid-Autumn Festival, Qingming, Duanwu, May Day holiday and National Day holiday. Western holidays like Valentine's Day and Christmas are also increasingly celebrated here. International sporting events (Olympics, World Cup Soccer) are also very popular, and association with special events like weddings and business celebrations can provide good business opportunities.

**SECTION III: COMPETITION**

Imported food accounts for around 24 percent of the total value of China's food and beverage sector – as such, the imported foods market in China is very competitive with suppliers from around the world battling for market share. Australia, New Zealand, South Africa and the European Union are most likely to supply products that compete with American products. European suppliers in particular provide heavy support for chefs, and the media including regular training in China and abroad.

Future food trends in China include:

1. Increased focus on healthy and nutritious products that deal with obesity and food safety;
2. Growing popularity of 'fusion' foods that combine western and Asian flavors;
3. Widespread exposure of Western food because of the popularity of chained mass-marketers like KFC and McDonald's;
4. Value-added, self-service, portion control, increased food safety, and value for money or cost perceptions all are working to enhance the viability and acceptance of Western food options here.

In response to consumer demand for healthier foods, both McDonald's and Yum! Brands (KFC, Taco Bell and Pizza Hut) have introduced alternatives to traditionally perceived high-calorie Western fast food. Yum! Brands China launched a Chinese-style fast food chain 'Dongfang Ji Bai', also introduced healthier options like porridge, salads and wraps have also found their way onto McDonalds and KFC menus.

Imported U.S. food products have an excellent reputation for consistent quality. Chefs' exhibit strong loyalties to US beef, despite the fact its unavailability at present. French up-market cheeses, yogurt and chocolates and Norwegian salmon are also considered premium quality. New Zealand and Australia have a clear proximity advantage in shipping times and cost, and dominate standard dairy imports destined for the HRI Sector here.

Most imported products face at least some locally manufactured and lower priced competition, unless it is something China doesn't produce at all (for example, olive oil). In addition, multi-nationals such as McCormick and DANONE manufacture products in China as well for cost or market access reasons. Recently, a number of small companies have appeared near major cities, successfully producing highly perishable international food like mozzarella using overseas technology. Domestically produced product quality is improving; so, chefs and purchasing managers are increasingly faced with the decision of either substituting imported with a variety of improved local foods and food products.

Some buyers believe China will never be able to produce commodities that require large-scale corporate farming operations. For example, China still imports around 70% of its French fries, because Chinese growers have difficulty most years producing potatoes that are consistent in quality and economically competitive.

Counterfeit goods are another important competitive factor for products from the U.S. When a brand is established, counterfeit and cheap imitations often follow. Bad experiences with a high-priced "import" that is actually counterfeit can tarnish brand names and affect business for years. As a rule, QSR and high-end restaurants make a significant effort to ensure the integrity of the products it uses as genuine.

US product has a slight currency advantage due continuing appreciation of the RMB relative to the US Dollar, which make American products slightly less expensive relative to European or Australian products. However, the differences are still somewhat minimal and any cost savings are often not passed onto the consumer. The RMB is expected to continue its rise against the dollar, but some sources believe a major shift is less likely in the near term.

## Imports and Competition

Product Category	Major Sources	Strength of Key Suppliers	Advantage/Disadvantage of Local Suppliers
<b>Beef</b> (fresh/chilled) Imports \$8 mil	1. Australia, 99% 2. Brazil	Australia is clear leader as US out of China's beef industry is nascent and the market due to BSE-related restrictions. A very strong rebound is expected when restrictions on US product lifted.	meat quality not generally acceptable for stand-alone use such as steaks.
<b>Beef (Frozen)</b> Imports \$9.99 mil	1. Australia, 65% 2. Uruguay, 32% 3. New Zealand, 2.8%		
<b>Pork</b> Imports \$523 mil	1. USA, 60% 2. France, 14% 3. Denmark, 13%	US topped the list, surpassed France, China's pork industry is large, but is Denmark and Canada. Strong export still made up of small farms with low production efficiency, poor consistency, and variable quality. However, the sector is consolidating and investment is increasing.	
<b>Poultry</b> Imports \$1bil	1. USA, 75% 2. Argentina, 22% 3. Chili, 2%	US products have clear advantages on quality and quantity supply. Chicken paws account for a large share of imports.	China's poultry industry is developed however quantity of products is insufficient to satisfy the domestic market.
<b>Fish and Seafood</b> Imports \$3.6 bil	1. Russia, 33% 2. US, 14% 3. Norway, 5%	A large portion of imports from Russia are processed for re-exporting and some for local consumption.	Chinese prefer live fishery products. Much of local products are less processed compared with imported products.
<b>Dairy (Milk &amp; Cream)</b> Imports \$401 mil	1. New Zealand, 54% 2. Australia, 22% 3. USA, 15%	New Zealand and Australia have aggressive suppliers, low costs, and advantages in shipping time.	China's dairy industry is growing very rapidly, but still in an early stage of development. It produces milk and yogurt but doesn't really compete in cheeses or butters. The 2008 milk scandal reduced consumer confidence in local products.
<b>Dairy (Cheese &amp; Curd)</b> Imports \$73 mil	1. New Zealand, 39% 2. Australia, 22% 3. USA, 15%		
<b>Wine</b> Imports \$1 bil	1. France, 39% 2. Australia, 16% 3. Chili, 14.9% 4. Italy, 7% 5. USA, 5%	France is a strong market leader, which is largely due to its early entry into the China market. Wines from Australia, Chile and other origins have price advantages over American wines.	China's wine industry is evolving with a few good wines, however it may take decades to catch up with international market leaders.
<b>Breakfast Cereals</b> Imports \$698.9 mil	1. Australia, 50% 2. Thailand, 26% 3. Canada, 13%	US occupies 0.46% market share, China's cereal industry is evolving and however in north China HRI and retail, US products top the market.	China's cereal industry is evolving and growing very rapidly with more consumers seeking quick and nutritious breakfast options.
<b>Grapes (fresh, dried)</b> Imports \$114 mil	1. USA, 47% 2. Chili, 39% 3. Peru, 9%	Total Value increased 41% over 2007. The US has been the leader in this market for the past 3 years.	Local products cannot compare with the quality, variety and taste of US imported products.
<b>Soups &amp; Broths</b> Imports \$12.7 mil	1. Australia, 48% 2. Japan, 21% 3. USA, 15%	The US is considered a quality leader in this category.	Demand for prepared products is escalating rapidly in the HRI sector. Local products have yet to catch with international competitors.
<b>Fruit + Vegetable Juice</b> Imports	1. Brazil, 61% 2. Israel, 8.7% 3. USA, 8%	US products are still dominant in the north China market	Domestic products fewer varieties compared with imported products but are competitive in some sectors.

Source: World Trade Atlas 2008

**SECTION IV: BEST PRODUCT PROSPECTS**

Interviews with HRI food service professionals repeatedly confirm that US food exporters should select top quality products for export to China. U.S. foods benefit from expectations of high quality, attractive appearance, convenient package and food safety. On the other hand, it is difficult for most US food products to compete with Chinese domestic products on price, particularly for those foods in demand by the HRI market. Instead, suppliers should target niche as well as regional markets with top-quality products that are unique, healthy, and nutritious.

U.S. beef has been banned for import in China since December 2003 as a result of BSE. Food service professionals in the HRI sector remain committed to using US beef due to consistent and unparalleled quality, and note that it out easily out-competes competitor suppliers on flavor and appearance. Salmon, from a variety of country suppliers, is a popular import item, used widely in Japanese kitchens. American lobster, particularly live lobster, generates much interest; however, high costs and losses associated with shipping live product have resulted in a market dominated by Australian lobster. U.S. citrus, apples and table grapes from the US remain strong competitors in the imported fruit market, especially during the off season for domestic products. Tree nuts are also very popular in China, especially almonds, walnuts, and to some extent pistachios, as a result of perceived health and nutrition benefits.

As China's economic development continues and interest in processed food grows, the secondary production of goods, such as meat and fish, may well become attractive to manufacturers and agricultural sub-sectors may also manage to profit from foreign direct investment. The secondary stage of processing such goods, for example, sliced meats, prepared chicken, etc., has had a huge impact on HRI sector sales. Also, ready-to-use and value-added products considered unlikely prospects only a few years ago are increasingly in demand. Ready-made, pre-cooked and portion-control sauces, soups, pizzas, vegetables, fish fillets, meat and meat products, and frozen dough.

Likewise, organic food in China could be a strong long-term opportunity. At present, due to a lack of local understanding of organic with little investment in the sector, the industry is under-developed with official organic agriculture representing much less than 1 percent of domestic agricultural production. The higher price for organic products and lack of awareness of the concept means China's organic market is still in its early phase. However, with careful promotion, high-quality imported organic products appeal to hip, young professionals, and their grandparents who remember when it was safe to eat an apple without peeling it first. These products have good potential in China's increasingly food-safety conscious market.



In the Market with Potential	Present and with Good Potential	Products not Present or Diminishing
Beef (if import ban lifted) Beer Bottled water Breakfast cereals, muesli Chocolate Chicken paws Coffee Condiments Cream Dairy Frozen potatoes (French fries, wedges) Frozen berries Fruit (grapes, grapefruit, oranges, Kiwi) Lamb Liquor Nuts and dried fruit Olive oil Pasta Pork Potato preparations Premium fruit juices Premium yogurt Seafood (lobster, tuna, salmon, mussels, seaweed) Veal Wheat flour Wine	Organic foods; Pre-cooked sauces; Portion-control fish fillet and meats; Cheese; Butter; Bulk cheese for catering use; Colors and flavors; Fresh, Canned and maraschino cherries and other berries; Turkey and other poultry products	Fresh Fruits (domestic substitution of apples, pears) Mayonnaise (JV manufacturing in China) Ketchup (JV manufacturing in China) Baked potatoes Onion rings Red cabbage (domestic substitution)

**SECTION V: POST CONTACTS & OTHER RESOURCES**

For further information about the China market, as well as updates on our upcoming events and activities, please visit our website at [www.usdachina.org](http://www.usdachina.org) or contact one of USDA's six offices in China:

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