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# **China, Peoples Republic of**

## **Retail Food Sector**

### **Report**

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#### **Report Highlights:**

**China's food retail sector has experienced remarkable growth during the past ten years, and at the same time undergone profound structural transformation. In the early 1900's, wet markets and non-staple food stores were the norm, yet in the most recent five years these have been largely replaced by supermarket and convenience store chains. This retail revolution has been more rapid and evident in larger Chinese cities, such as Shanghai, Guangzhou, Dalian, and Beijing, but the trend is unmistakably present for the whole of China.**

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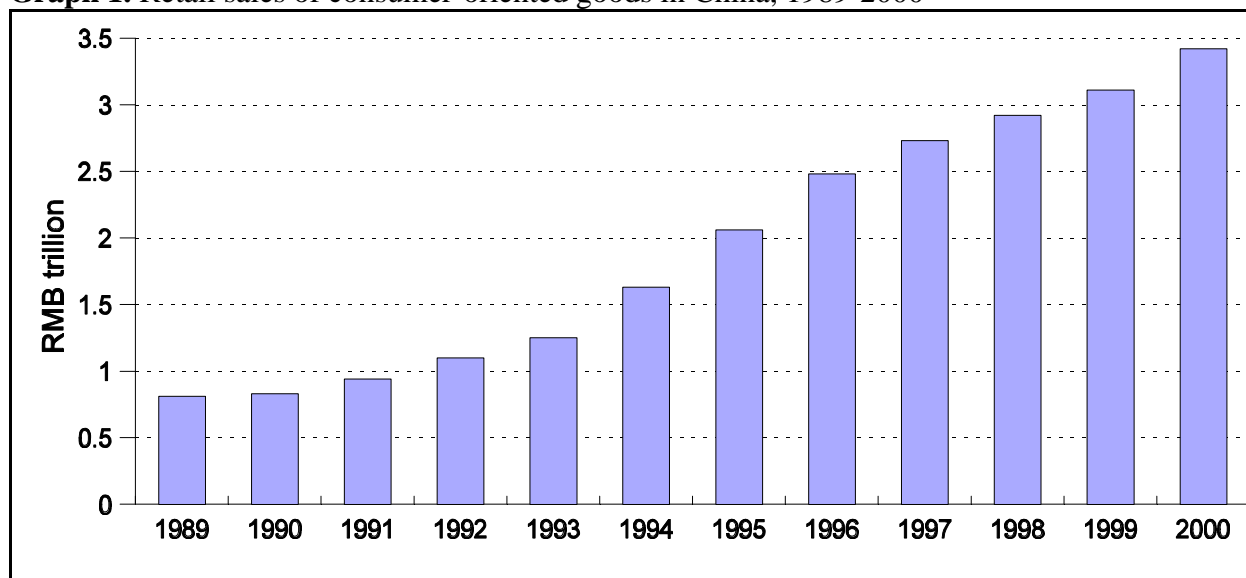
## I. MARKET SUMMARY

### I.1. Executive Summary

China's food retail sector has experienced remarkable growth over the past 10 years (see Graph 1 below), while at the same time undergoing profound transformation. In the early 1990's, wet markets and non-staple food stores were dominant, but in the past five years most have been replaced by supermarket and convenience store chains. This transition has been more rapid and evident in larger Chinese cities, such as Beijing, Shanghai and Guangzhou, but the trend is unmistakably present for the whole of China.

In just the past couple of years, the arrival of foreign-invested hypermarkets, discount stores, and warehouse clubs, such as Carrefour, Wal-Mart, RT-Mart and Metro, has furthered changed the Chinese retail sector. According to the State Statistical Bureau, China's total retail sales rose 9.7% in 2000, to RMB a level of 3.42 trillion (US\$413 billion), with major foreign chains here accounting for the lion's share of the growth. This is forcing traditional supermarket chains to restructure and consolidate in order to stay competitive. Frozen and chilled product sections are rapidly developing as a basic component of most supermarkets in China. Availability of fresh fruit and vegetables outside traditional wet markets continues to expand rapidly.

**Graph 1.** Retail sales of consumer-oriented goods in China, 1989-2000



(Source: China 2000 Statistical Yearbook)

In today's China, food retail management, warehousing and merchandising are increasingly sophisticated. Chinese consumers, exposed to higher quality and the latest food products from abroad, have become increasingly quality-conscious. Local consumers exhibit a growing preference for improved shopping environments, and are sometimes willing to pay a significant premium for high-quality, organic, nutritious and healthy food products.

Penetrating the lucrative Chinese retail market, however, is no easy task for exporters of food products. High duties are levied on imported products, making them considerably more expensive than their locally made counterparts by the time they land on the supermarket shelves. Obtaining the necessary hygiene certificates, modifying product labeling to comply with Chinese standards, and building a brand name with Chinese consumers are all convoluted and expensive – but necessary – undertakings. Finding the right Chinese partner, establishing a reliable import channel, maintaining an efficient sales and distribution network, and breaking into the leading volume-generating retail chains are among the crucial challenges exporters are faced with.

This report aims to provide a somewhat comprehensive overview of China's urban retail sector, focusing particularly on food and beverage products. Many of the issues related to food, in fact, are also characteristic of the entire consumer-goods retail sector. Some market entry strategies are included by ATO Shanghai, with sources for further information and research are provided.

## **I.2. Brief History**

The retail industry in the average Chinese city has changed profoundly over the past 20 years. As recently as the late 1980s, Chinese consumers got their daily necessities at a few highly specialized outlets, for example:

- ! Rice and cooking oil – from the grain and oil store;
- ! Canned food, condiments, processed foods and snacks – from the foodstuff store;
- ! Fresh meat, eggs and vegetables – from the local wet market;
- ! Clothes, shoes and other basic consumer goods – from specialized stores or factory outlets.

The late 1980s and early 1990s, saw the advent of multi-level department stores, when all consumer items moved under the same roof. Concomitantly, a larger selection of consumer goods appeared for sale inside these department stores, including home appliances, consumer electronics, toys, fashion, and a growing array of snacks, confectionery and processed foods.

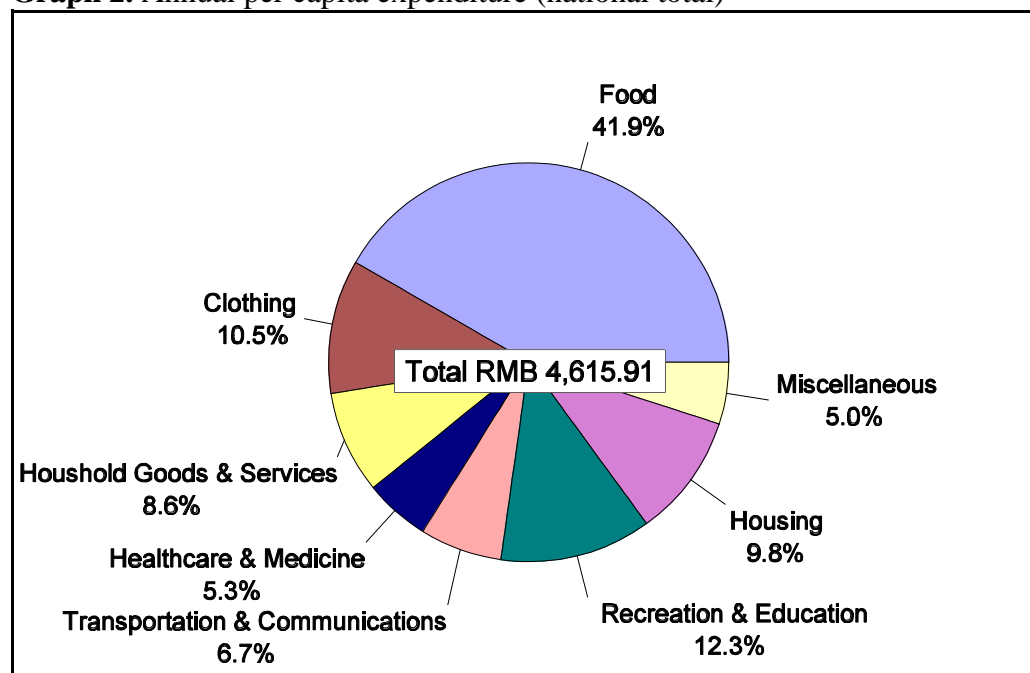
In the past five years, China's retail sector has been transformed. The proliferation of supermarkets and convenience stores, modeled after the popular commercial formats in Western and Southeast-Asian capitalist countries, has brought more choice and comfort to Chinese consumers. The sector attracted considerable investments from major international retailers, many of which established joint-venture operations throughout the country. Another foreign concept, chain stores, has helped consolidate the sector and reinforce branding.

The success of the hypermarket format, pioneered by foreign retailers such as Metro of Germany, Makro of Holland, and Carrefour of France, has been driving the latest phase of China's retail revolution. Now Chinese consumers can get their dry groceries, fresh meat, fruit and seafood, as well as clothes, household goods and electronics in the same clean, air-conditioned and professionally managed superstore. Supermarkets and convenience stores, for their part, are adapting to fill the local neighborhood niche left by the hypermarket giants. But cut-throat competition remains endemic to the entire sector.

### I.3. Food Retailing

Food is not just a major consumer-product category for Chinese households, it is also an important part of culture and family life. Consumer foods have been a driving force behind China's retail revolution. Food plays a very central and important role in family affairs and in business relationships. Packaged foods (e.g. confectionery, snacks, beverages) and fresh foods (e.g. fruit, seafood) are also preferred gift items, which are offered to family members, relatives, colleagues and business contacts on occasions, such as anniversaries, birthdays, weddings, Spring Festival, Children's Day, Mid-Autumn Festival, etc.

**Graph 2.** Annual per capita expenditure (national total)



(Source: China 2000 Statistical Yearbook)

Food products are widely available across the spectrum of retail stores in China – not just in food-driven outlets, such as supermarkets, convenience stores and Mom & Pop stores, but also in more traditional department stores, which normally dedicate at least one level to food items. The main types of food products available for retail are:

- ! dry groceries (e.g. confectionery, snacks, canned food, baby foods)
- ! fresh produce, seafood and meat (e.g. fruit, vegetables, pork, beef, poultry, eggs, fish)
- ! frozen and chilled foods (e.g. frozen vegetables and meat, seafood, ice cream, milk, yogurt)
- ! soft drinks, alcoholic beverages (e.g. water, fruit juice, carbonated drinks, beer, wine, liquors)
- ! ready-to-eat (RTE) foods and preparations (e.g. bakery, chicken, deli foods, dumplings)

Each of these main categories has a characteristic distribution channel (described in more detail under Section II), and dedicated floor space within a food retail outlet. Avant-garde retail formats, such as hypermarkets and convenience stores, are striving to incorporate all of these categories and present a complete scope of product choices for China's modern consumers.

The penetration of imported foods into the Chinese retail market is still fairly shallow. With the exception of a few supermarkets in major cities catering almost exclusively to expatriate communities, most retail outlets are stocked with locally produced foods and beverages. Foreign brand names, such as Coca Cola, Pepsi, Hormel, Mars, Cadbury's, are widespread, but all of these products are now locally produced by joint-venture companies or under license. Truly imported foods account for less than 5% of the food stocks of the average supermarket or hypermarket. They are even less common in other retail formats. But many leading chains are realizing that featuring more and better quality imported foods and beverages is a good way to distinguish themselves in a highly competitive market, and attract more customers. Several chains are either exploring the opportunity or already establishing sourcing operations in the US and other western countries, with the intention of increasing their portfolio of imported products, particularly dry groceries, frozen foods and RTE foods.

#### **I.4. Retail Universe**

The average city in China now offers its citizens a broad spectrum of retail outlets to choose from. Food, being the largest household expenditure, is widely featured at a variety of stores and markets. It is quite difficult to produce reliable statistics on store outlets and sales, since there is no unified official government source of retail census data. (A number of private market research companies provide products and services designed to measure and track retail census statistics, please contact the ATO Shanghai for a list of market research firms active in China.)

Table 1 below is an approximation provided by ATO Shanghai of the retail universe of a major city (e.g. Shanghai, Beijing, or Guangzhou) and a secondary city (e.g. Chengdu, Dalian, or Qingdao) in China. It does not contain precise statistical figures, but is rather intended to give an overall idea of the primary retail players, market segmentation and competitive environment. The terms referring to different store types, defined in Table 1, will be used throughout this report.

**Table 1.** Typical retail universe in an average major and secondary Chinese City

Store Type	Size in sqm (approx.)	Number of outlets/chains (approx.)		Percent operated by chains (approx.)	Fresh produce	Frozen foods	Ready-to-eat	Non-food
		... in a major city (e.g. Shanghai, Beijing, Guangzhou)	... in a secondary city (e.g. Chengdu, Dalian, Qingdao)					
Hypermarkets	3,000-30,000	50/5	15/2	90%	✓	✓	✓	✓
Supermarkets	600-3,000	1,200/3	300/2	75%	✓	✓		✓
Department stores <sup>1</sup>	500-1,000	40/5	15/2	50%		✓		✓
Foodstuff stores	200-1,000	20/0	10/0	0%				
Convenience stores	30-100	1,600/5	800/2	65%		✓	✓	✓
“Mom & Pop” stores	5-20	30,000/0	20,000/0	0%				✓
Wholesale markets	10,000-50,000	10/0	2/0	0%	✓	✓		
Wet markets	2,000-20,000	50/0	20/0	0%	✓		✓	

(Source: ATO Shanghai Approximation)

<sup>1</sup> “Department stores” refers to supermarkets or grocery stores operated by and within a multi-storey department store, usually occupying the basement level.

For a more in-depth description of the different retail store types, please see Section II.

### 1.5. Import Logistics and Distribution

Importing and distributing foods in the China market is a complex and challenging task. The channels that have traditionally supplied imported foods to the market (most notably gray channels via Hong Kong) are generally opaque, unreliable, and shrinking due to increased scrutiny by the central government in Beijing.

The gray channels thrived in the early and mid-1990s, when foreign suppliers found the best route to the Chinese market was through small Hong Kong-based distributors with strong networks in mainland China and good connections to customs and other government officials. These Hong Kong companies were able to deliver foods into China at a competitive price by avoiding import duties and fees through smuggling, or by reducing duties and fees through under-invoicing (declaring less quantity or lower unit price than what is given on the original shipping documents). In addition, the Hong Kong companies often acted as foreign-currency clearing houses for the import transactions, accepting payments in RMB from their Chinese buyers and remitting hard currency to their overseas suppliers. The boom of the gray channels turned South China, and Guangdong province in particular, into the center of the country’s import trade in consumer food products.

In 1998, the central government launched a massive anti-smuggling campaign, clamping down on illegal gray channel activity, considerably constricting the capability of these channels to supply products efficiently and reliably. Since then, an increasing number of foreign exporters have invested much effort and capital into building legitimate import channels directly through mainland ports, such as Shanghai, Dalian, Qingdao and Tianjin. China's eminent WTO membership will result in lower tariffs and is expected to bring more transparency to import trade, has further reinforced this trend. The gray channels are still operational, albeit on a smaller scale and at a higher cost, and represent one viable channel to import consumer food products. The long-term strategy exporters should be considering, however, is to move away from risky and unreliable gray channels and explore direct legitimate channels with mainland importers.

Importing and selling foreign-made food products is increasingly complicated in China, particularly when one intends to comply with all the rules and regulations. New laws and standards are continuously being introduced to prepare China for its WTO membership. While in the long run they will bring transparency and a legal framework to the import trade, in the short term they are often causing confusion among local traders and foreign exporters.

The most important task for an exporter is to identify and sign up with a company known as an "importer" or "general distributor". The importer must be able to handle all the import formalities (i.e. act as a customs and logistics broker) and have a network of established retail customers, such as supermarket or convenience store chains (i.e. act as a distributor). Above all, the importer must be able to pay for the imported products by remitting hard currency to the exporter overseas. Most active importers of high-value food and beverage products are either smaller, well-connected state-owned trading companies or privately owned and/or run entrepreneurial businesses. Both types traditionally do not have import rights (i.e. licenses) or access to foreign-exchange funds, which are still prerogatives of large state-owned import/export corporations. The general distributor employs the services of an import/export corporation, acting as an import agent, and pay (normally 1-2% of the transaction value) for the use of its import license. The import agent is the entity that submits the import documentation and (at least on paper) appears as the importer before customs authorities. Often, however, the payment for the goods is also by the import/export corporation, which is more likely to be able to open letters of credit or transfer hard currency overseas.

Once past customs and entry/exit quarantine inspection, the product is stored in warehouses either rented or owned by the general distributor. It is dispatched on demand to retailers or secondary distributors in trucks, either rented or owned by the general distributor. More often than not, importers handle consolidated container loads of various consumer-food products ordered by one or several end-customers (e.g. a hypermarket or supermarket chain). It is not customary for importers to maintain inventories of imported food products at their own expense. If a sizeable inventory is maintained, whether in a regular or bonded warehouse on Chinese territory, it is normally at the expense of the foreign exporter or manufacturer. Secondary distributors and retailers keep small stocks and reorder only if sales are satisfactory.

Leading hypermarket chains, such as Carrefour and Wal-Mart, owe their success in part to the fact that they have managed to bypass China's inefficient and low-tech wholesale system, and are ordering directly from suppliers and manufacturers. Fierce competition among food suppliers

and manufacturers, struggling to enter the best performing retail chains, has resulted in the emergence of a source of extra income for retailers – listing (a.k.a. slotting) fees. Retailers charge suppliers of consumer-oriented products a one-time listing fee for the opportunity to place a product on the shelves of their stores. Listing fees can be steep at the best retailers, such as Carrefour, reaching as high as RMB 10,000 per SKU per store. For example, a supplier trying to sell a product line of two flavors that come in two different package sizes in 3 stores (i.e. four SKU's per store) will have to pay twelve times the listing fee. Additional charges are levied for prime shelf space and special off-shelf promotion space. In addition, retailers normally charge for any in-store promotion activities supplier may want to conduct.

Most retailers also demand burdensome credit terms of their suppliers – 90 to 180 days being quite common. Leading hypermarkets also require that products meet certain sales performance criteria. Products that fail to meet the sales criteria “scroll off” their shelves in as little as a month. To re-list the same products anew, suppliers have to pay the listing fee again.

Another challenge that food products, both domestic and imported, face is the myriad of licenses required to sell in the retail market. All food products must receive a hygiene certificate from the local government, wherever the store they are listing in is located. Food products also have to be labeled in accordance with the latest labeling regulations, which for many imported products means developing new labels and packaging in Chinese. Functional or health foods must obtain a health-food certificate. Products containing GMO (genetically modified organism) ingredients must obtain a GMO safety certificate and be properly labeled. Many of these regulations are either new or ambiguously worded, and their enforcement is arbitrary and opaque. Foreign exporters are advised to entrust all responsibility for certificates and approvals to their Chinese partner or distributor, while making themselves aware of the basic requirements and standards.

In the past several years, a small number of service-oriented logistics companies, many of them with foreign participation and management, have been established in port areas and near free-trade zones. Their business model offers a one-stop-shop solution for companies interested in importing into or exporting from China. They offer customs clearance, shipment handling and storage, bonded warehousing, as well as foreign exchange clearance for imports. They are also able to dispatch products on demand, and maintain transparent international-standard accounting for their customers. ATO Shanghai recommends that US exporters consider the use of logistics providers when planning their long-term strategy for the China retail market.

## I.6. SWOT Analysis

**Table 2.** China retail sector SWOT analysis

<b>Advantages and Challenges Facing US Food Products in China's Retail Sector</b>	
<b>Advantages (Strengths, Opportunities)</b>	<b>Disadvantages (Weaknesses, Threats)</b>
American products are considered to be of high quality by Chinese consumers	There is little awareness of American products and brands among Chinese consumers
Chinese consumers and retailers are attracted to the superior packaging and quality of imported foods and beverages.	Imported food and beverage products are burdened with high duties, labeling and hygiene requirements, and inspections.
Major urban centers, such as Shanghai, Beijing and Guangzhou, have sizable populations of high-income consumers. In addition, consumption in China's numerous secondary cities is rising steadily.	The average income and per capita consumption of Chinese consumers is very low. They tend to be savers rather than spenders.
China is expected to accede to the WTO by early 2002, which (at least on paper) will mean greater market access and national treatment (i.e. no double standard) for foreign traders and investors.	China's legal system and infrastructure are underdeveloped, and enforcement is erratic and often biased. Corruption and local protectionism are likely to remain serious problems for some time.
Chinese consumers spend almost half of their disposable income on food & beverage products. Food is an essential part of Chinese culture and social interactions, and food products are a preferred gift.	Chinese consumers are extremely price-sensitive. In this highly price-driven market, imported products have a difficult time competing with their locally manufactured counterparts.
The retail sector is undergoing a dynamic transformation, driven by hypermarkets and convenience chains, which are attracting increasing numbers of sophisticated urban shoppers.	The distribution and logistics sector is greatly under-developed in China, and nationwide distribution is cumbersome and expensive.

## II. ROAD MAP FOR MARKET ENTRY

### II.1. Entry Strategy

There is no particular strategy for successful penetration of the Chinese food market that this office categorically endorses and recommends. However, there are certain elements of an exporter's entry strategy that we deem important or even crucial. On the basis of our long involvement in this market and experience with many successful (and many failed) export-trade businesses, we recommend that prospective exporters include the following basic steps in their strategy for the Chinese food and beverage market:

**! Invest (wisely!) in market research and testing**

Everything is different in China – tastes, customs, culture, infrastructure, business rules, etc. Even the most successful and experienced foreign businessperson would be wise to spend some quality time (and resources) carefully identifying and studying his target market. Testing every attribute of a new-to-market product (including flavor, packaging, pricing, shelf life) is highly recommended, particularly using a more qualitative approach, such as consumer focus groups. This is not to say that one must budget tens of thousands of dollars to hire a top international market research firm. In fact, in the absence of reliable government data and given restrictions on public polling, the quality of research by most international market research firms is only marginally better than that of their local (and considerably cheaper) counterparts in our experience. But an exporter with a long-term vision for China should dedicate enough time and resources to become familiar with the market and to test the strengths and weaknesses (particularly consumer acceptance) of his product in this market.

**! Find a local Chinese partner and/or distributor (crucial!)**

A foreign exporter's success in China hinges on his local Chinese partner, representative or distributor. There is no way one can manage an export business for the Chinese market remotely. There is constant need to interact with Chinese government authorities, buyers (distributors and retailers), as well as to stay on top of the latest consumer trends and moods. Exporters choose one of several possible arrangements to establish representation in the China market: sign up a general distributor, set up a representative office, or form a joint venture or partnership with a strong importer/distributor. An exporter's choice should be made carefully, following a diligent study of the market conditions and his product-specific requirements. Hastily made partnerships are perhaps the most common cause of failure in China. (See Section I.5. for what to expect of a good general distributor or partner.)

**! Find your market audience, segment or niche, and focus on it**

Faced with the enormity and the vast potential of the Chinese market, some exporters are tempted to diversify too much, too early, and to try to cater to the entire market spectrum. Often, this is a recipe for disaster. Especially given the enormity and diversity of the Chinese market. It is important for an exporter to identify the target market (gourmands, or health-conscious mothers, or thrifty grandparents) and serve it faithfully and consistently until their sure of

success. Trying to fill every niche leads exporters to lose focus and spread resources too thinly.

! Go it slow in the beginning, pursue gradual but sustainable growth

Another potentially perilous temptation for foreign investors and traders in China is to attempt to achieve mercurial growth (especially in geographic distribution and store penetration) in the first year, either to amass market share or to impress financial investors. While this may produce good results if steady long-term demand for their products exists, more often than not, exporters end up stretching their resources across vast and disparate geographic areas, and are seldom able to concentrate on the requirements of each local market. In such cases, the sudden weakening of demand or the appearance of competition usually proves fatal. Exporters are better advised to draft a less ambitious plan, devoting sufficient time and resources to each local market and expanding only on the basis of tangible successes and real demand.

! Adapt your product to the Chinese market – labels, flavors, package size, price (!)

China now has detailed regulations on food labeling (requiring Chinese language labels for all imported foods), and their enforcement will only get stricter. Exporters are wise to invest in proper labeling for any products with long-term market potential. Furthermore, based on their market research, exporters should be prepared to make modifications to a product's flavor, color, packaging design and size. Most importantly, they should aim to offer an attractive unit price.

! Invest in market promotion (wisely!) – trade shows, in-store promotions

Once successfully in the market, an exporter's product will be competing with tens – if not hundreds – of other similar products. The domestic ones will have the advantage of lower costs, local protectionism/loyalty, and limited marketing, while the imported ones will be aided by fervent advertisement and promotion. Trying to match the advertising budgets of multinationals like Coca Cola or Nestle could be a drain on operating capital. But without any marketing support, a product will have a hard time winning over consumers and distributors. The average exporter, therefore, should design and implement his marketing campaign wisely. Attending only quality trade shows is a good way to start. Once in the market, in-store promotions have proven to be a cost-effective way to support an important distributor or retailer. Above-the-line media advertisement should be carefully planned, as TV and radio stations have limited and local only reach at a high cost. Exporters are advised to explore joint marketing opportunities with local ATOs or their State Regional Trade Group (WUSATA, MIATCO, SUSTA & EUSAFEC).

## **II.2. Major Retailer Types and Profiles**

This section aims to provide more detailed information about various types of retailers active in the Chinese retail scene, focusing on their historic and current role, procurement and distribution systems, and the major trends impacting their business and development. Tables 3 - 6 provide general profiles of the major players in each of the main retailer categories. There is no precise and reliable government or industry data on retailer profiles; these tables are based on online and offline research conducted by the ATO Shanghai. We have made an effort to provide as much information as is publicly available and, where we feel confident, to offer our or other experts'

estimates. However, all numbers in the following tables, which in some cases are approximate, incomplete and/or based on different reporting years, should be used for general reference only.

**Table 7.** China's Top 10 Retailers in 1999

<b>RANK</b>	<b>RETAILERS</b>	<b>TOTAL SALES (RMB billion)*</b>	<b>MAIN BUSINESS</b>
1	Lianhua Supermarket Co.	7.31	supermarket, convenience store chain
2	Shanghai No.1 Department Store Co.	6.12	department store
3	Carrefour (China)	6.00 (est.)	hypermarket chain
4	Shanghai Hualian Co.	4.28	department store
5	Hualian Supermarket Co.	4.20	supermarket chain
6	Shanghai Yuyuan Mart Co.	4.01	department store
7	Sanlian Commerce Corp.	3.43	specialized store
8	Shanghai Agriculture-Industrial-Commerce (Nong-gong-shang) Supermarket Co.	3.16	supermarket chain
9	Wal-Mart (China)	3.00 (est.)	hypermarket chain
10	Dalian DaShang Group Co.	2.92	department store

(Source: China Supermarket Chain Store Association)

\* This is 1999 revenue, thus the discrepancy with 2000 revenue cited in Tables 4 and 5.

## **II.2.A. Hypermarkets and Cash & Carry Discount Warehouse Clubs**

Hypermarkets are the new face of China's retail sector, the format driving the consumer retail revolution. They started as what then seemed brave experiments by European veterans in the sector, such as Metro and Makro. Skeptics were quick to predict their fate, observing that Chinese consumers never shopped in large quantities, that glitzy foreign-brand shops were immediately associated with high prices, and that the low level of automobile ownership would preclude most consumers from visiting and shopping at the large cash & carry centers. But two things made hypermarkets an overnight success in China: convenience/comfort and low prices. They made shopping easier and more pleasant by offering the full range of consumer goods (fresh produce, groceries and non-food) under one roof, in a clean, air-conditioned superstore. More importantly, they offered low prices by keeping procurement and warehousing costs down. Foreign hypermarkets pioneered the concept of nationwide (or region-wide) purchasing centers, bypassing the multi-layered, fragmented, inefficient (and therefore, costly) purchasing network of wholesalers and distributors that serviced old-fashioned department stores and even supermarkets. By buying directly from the manufacturers and charging them exorbitant slotting

fees, hypermarkets were able to gain the most effective competitive edge in China: price.

Today, hypermarkets are the leading retail format, and the trendsetters of the sector. They are increasingly in vogue not just with consumers, but with top state-owned retailers who have so far been engaged mainly in department-store or supermarket formats. In addition to obvious benefits for consumers, hypermarkets offer manufacturers and suppliers of consumer goods the promise of consistently large sales volumes and nationwide distribution reach. In reality, none of the hypermarket chains – not even high-flying Carrefour – has achieved out national penetration or distribution as yet. Suppliers still have to negotiate with and deliver to each store individually. Each store is given a large degree of autonomy on procurement and is expected to achieve and maintain its own profitability. Nonetheless, the potential for a nationwide, yet centralized, distribution network has strong allure for suppliers. Hypermarkets generally purchase either directly from manufacturers or through large distributors. Imported goods, which account for 5% or less of their stocks, are sourced through established import agents or general distributors (See Graph 3 under Section II.3.) Since most leading hypermarket chains are foreign-invested ventures with key executives who are either from or were trained abroad, their store management and purchasing mechanisms are modern and sophisticated, and therefore less reliant on or conducive to Chinese-style business *guanxi* (relationships). Hypermarket managers are anything but “accessible”, particularly to a small or medium-sized supplier keen to penetrate their chains. Yet their relative operational independence makes some relationship-building necessary.

The innovative marketing and broad range of choices and services hypermarkets offer have proven a hit with Chinese consumers. A typical hypermarket consists of a “marketplace” (usually situated on the 2<sup>nd</sup> and 3<sup>rd</sup> floors) and a “retail plaza” (usually at ground level). The retail plaza hosts a variety of designer shops and boutiques (fashion, accessories, sporting goods, etc.), fast-food restaurants, video-game arcades, photo shops, and other specialty shops. The marketplace is divided into food and non-food areas with non-food items ranging from clothing to kitchenware, household goods, electronics, sports goods, and toys. The food area is the core (and the main attraction) of the hypermarket. In addition to an extensive dry-groceries and frozen-foods section (which is what supermarkets had to offer in they heyday in the mid-1990s), a hypermarket’s food area is also host to a sizable fresh section, featuring fresh fruit and vegetables, fresh and frozen meat and seafood. In addition, various food-preparation counters, such as delis, bakeries, butcher shops, chicken rotisseries etc., line the sides of the food area. In-store promotions and demonstrations are an effective marketing tool and a common sight in Chinese hypermarkets.

**Table 3.** Profile of leading hypermarket chains with significant national presence

<b>Retailer</b>	<b>Ownership</b>	<b>Annual Sales (latest or estimated)</b>	<b>Number of outlets</b>	<b>Number of cities</b>
Carrefour	Sino-French	RMB 6 billion	27	15
Wal-Mart	US	RMB 3 billion	14	5
RT-Mart	Sino-Taiwanese	-	14	7
Metro	Sino-German	RMB 1.8 billion	10	7
Makro	Sino-Dutch	-	4	2
Lotus	Sino-Thai	RMB 1.5 billion	4	2
Trust Mart	Sino-Taiwanese	-	20	-
Auchan	Sino-French	-	2	1

(Source: ATO Shanghai Research)

## II.2.B. Supermarkets

Supermarkets, modeled after Western-style supermarkets or grocery shops, were rising stars in China's retail sector of the mid-1990s. What they offered consumers was increased choice and convenience. They focused on food products, in particular on dry groceries and packaged foods. The most noteworthy structural advantage they offered shoppers over the old department store format was freedom of access. Products were organized in aisles, displayed on multiple shelves, and customers, armed with baskets or carts, had direct and uninhibited access to all products. They were also cleaner and climate-controlled. As their acceptance grew, they quickly introduced another popular feature of their Western counterparts – frozen and chilled foods. The success of supermarkets marked the beginning of China's retail revolution, as consumers adopted the habit of shopping at a single store for a variety of food and non-food items.

Supermarkets are now the most widespread food retail format, with large state-owned chains dominating the scene. Foreign supermarket operators tested their luck, but had little success in this market. Dutch giant Ahold pulled out entirely after trying for a couple of years to jumpstart a chain of high-end supermarkets named Topps, and Hong Kong's Park'N Shop has retreated from almost all of its markets except Guangdong province. Fierce competition with domestic Chinese counterparts, for whom supermarket technology and management know-how were sufficiently available, made profitability an impossible task for the foreign-invested chains. This is not the case with hypermarkets, where foreign players still have an edge in know-how and management. Competition with large local chains has claimed another casualty – independent standalone Chinese supermarkets. Most have been forced out of business or acquired by state-owned chains.

But the most formidable challenge supermarket chains face is competition with the new giants in the sector, the hypermarkets. Supermarket chains have been responding by offering more services – the larger ones now provide fresh produce sections and food service counters (delis or bakeries). Most leading supermarket operators, such as Lianhua and Hualian, are also aiming to branch into the hypermarket format as a way to counter their foreign-invested rivals.

Supermarkets rely on less sophisticated purchasing systems. They work more closely with local

distributors, both large and small. Penetration of imported food products is as low as in hypermarkets, or even lower. Warehousing and store management systems are generally low-tech and less efficient than the ones of the foreign-invested superstores. Many of the established general distributors who bring in and distribute imported food products work closely with the leading supermarket chains. Relationships are much more important in the case of supermarket chains, where state-owned companies dominate. Supermarkets are generally worse-managed than hypermarkets. Their layout is often awkward and the atmosphere chaotic, which makes in-store promotions more difficult to stage and evaluate.

**Table 4.** Profile of leading supermarket chains with significant market presence

Retailer	Ownership	Annual Sales (latest or estimated)	Number of outlets/cities	Principal location(s)
Lianhua	Chinese	RMB 11.14 billion	650/50	Shanghai, East China
Hualian	Chinese	RMB 6.52 billion	606/	Shanghai, Beijing
Nong-gong-shang	Chinese	RMB 5.4 billion	200+/1	Shanghai
Park’N Shop	Hong Kong	-	61/4	Guangdong
Wumart	Chinese	RMB 1.27 billion	102/1	Beijing
Suguo	Chinese	-	170/3	Nanjing, Jiangsu

(Source: ATO Shanghai Research)

### II.2.C. Convenience Stores

Convenience stores are a relatively new phenomenon in China, although some of the early supermarkets were, in terms of space and scope of services, nothing more than convenience stores. In fact, there is no separate term for convenience stores in Chinese; they are simply called “small supermarkets.” Convenience stores started out as small-scale, often private, stores that employed the supermarket concept of self-service. Only after the success of hypermarkets began to squeeze local supermarkets, and following the arrival of a couple of foreign-invested convenience store chains such as Lawson and 7-Eleven, did the convenience store crystallize into a distinct retail format. With their relatively low-cost setup, local neighborhood presence, and long hours (often round-the-clock), convenience stores have proven more resilient than supermarkets and are complementary to hypermarkets. Local companies, most notably the largest supermarket operator Lianhua, have embraced the convenience store format, and have expanded the number of stores dramatically. Most new convenience store outlets replace a failing neighborhood food store. Franchising under the name of the leading chains, such as Lianhua or Liangyou, is the latest driving force in the sector.

Product selection is much more limited at convenience stores, and the focus is on impulse purchases of items such as packaged foods, drinks, ice cream, and ready-to-eat and warm snacks (such as sushi, dumplings, boiled eggs etc.) Imported products are rare. Many of the local chains are owned, or even run, by leading supermarket operators, and tap into the distribution and logistics networks of their parent companies. Foreign-run convenience stores, most notably Lawson, maintain a distribution network (warehouses and delivery-truck fleet) of their own. Marketing opportunities at convenience stores are limited to POP and on-shelf promotion.

**Table 5.** Profile of leading convenience store chains with significant market presence

Retailer	Ownership	Annual Sales (latest or estimated)	Number of outlets/cities	Principal location(s)
Lianhua	Chinese	RMB 11.14 billion	300/50	Shanghai, East China
Kedi	Sino-Hong Kong	-	120/1	Shanghai
Liangyou	Chinese	-	90/1	Shanghai
Lawson	Sino-Japanese	RMB 76 million	78/1	Shanghai
Basics	Sino-Hong Kong	-	60/1	Shanghai
7-Eleven	Sino-Hong Kong	-	50/2	Guangdong

(Source: ATO Shanghai Research)

## II.2.D. Department Stores

Department stores were the place to shop in the late 1980s and early 1990s. They offered the then rare opportunity to find a wide variety of consumer goods, including food, under one roof. Department stores were never focused on food products though, and that has remained the case today. Department stores usually dedicate one or one-half floor (usually on the basement level) to food items, and the format resembles that of a less sophisticated supermarket. Dry groceries and frozen foods dominate shelf space, while fresh produce or ready-to-eat foods are uncommon. Department stores are usually standalone operations and are rarely significant players in the food retail market. Most are state-owned and their purchasing systems are outdated at best. Often however, they are part of the same holding group as some of the supermarket or convenience store chains, and share in the group purchasing and distribution channels.

**Table 6.** Profile of leading department stores with significant market presence

Retailer	Ownership	Annual Sales (latest or estimated)	Number of outlets/cities	Principal location(s)
No.1 Group	Chinese	RMB 6.12 billion	10/1	Shanghai
Shanghai Hualian	Chinese	RMB 4.28 billion	1/1	Shanghai
Yuyuan Mart	Chinese	RMB 4.01 billion	1/1	Shanghai
DaShang Group	Chinese	RMB 2.92 billion	1/1	Dalian
Pacific Taipingyang	Sino-Taiwanese	-	8/5	Major cities
Parkson	Sino-Malaysian	-	4/4	Major cities
Jusco	Sino-Japanese	-	3/3	Major cities

(Source: ATO Shanghai Research)

## II.2.E. Foodstuff Stores

Foodstuff stores are a remnant of the past. They were the shops which under the old state monopoly system sold a limited range of processed and packaged food products. They are not self-service, and having to rely on a shop attendant behind each counter has proven no match for the modern retail formats. Historically, these shops have been selling candy, biscuits, traditional snacks (e.g. dried fruits), processed meats, Chinese liquors, and beverages. Foodstuff stores, which are also generally standalone (not chain) operations, are a declining format and not a major player in the food retail market. Some have tried to develop an edge by specializing in certain types of foods, such as health foods, children's foods, traditional foods etc., and may offer some opportunities for niche products. Management and purchasing are very low-tech, and a close

relationship with the store management is of great importance.

#### **II.2.F. “Mom & Pop” Stores and Kiosks**

“Mom & Pop” shops, also called corner shops, are almost exclusively privately owned and family-run. They are everywhere, and carry a limited range of impulse or basic consumer products: instant noodles, some confectionery (gum, mints, chocolate), some snacks, soft drinks (Coke, Pepsi and bottled water and tea), beer, and cigarettes. Some are equipped with a freezer for ice cream and other frozen foods (e.g. dumplings), and some specialize in fresh fruit. As a rule, “Mom & Pop” stores buy from wholesale markets, purchasing one or two cases at a time and keeping virtually no stock. They are an important segment of the market, but totally fragmented, unregulated and very difficult (especially for a foreign supplier) to deal with.

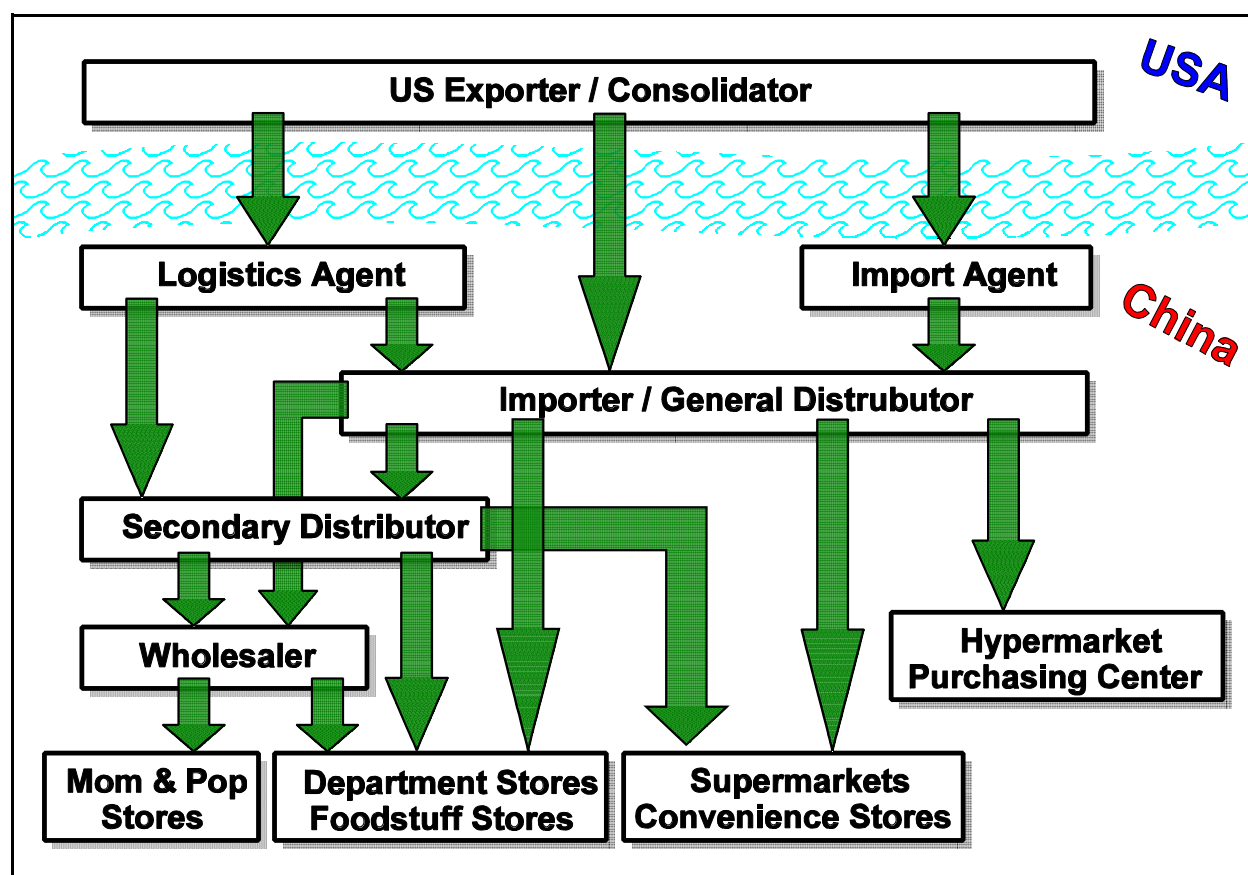
#### **II.2.G. Wet Markets and Wholesale Markets**

Wet markets are where Chinese consumers have traditionally shopped for fresh vegetables, meat and seafood. Wet markets are still operating, but are certainly on their way out. City governments are slowly but surely phasing out wet markets in an effort to improve hygiene and traffic conditions, and are either forcing them into large indoor markets or, more commonly, letting hypermarkets and supermarkets take on their functions. Wet markets deal almost exclusively in locally grown produce.

Wholesale markets are another remnant of a quickly disappearing distribution system. In the old fragmented retail environment, before chain stores and hypermarkets dominated the scene, manufacturers would sell primarily to a network of wholesalers who in turn had a *guanxi*-maintained network of retailers buying various consumer products from them. Wholesale markets are not, strictly speaking, a part of the retail universe, although retail customers may make a point to buy larger quantities of certain products (e.g. live seafood, holiday candy etc.) from a wholesale market stall. Wholesale markets still play a role in smaller inland cities and towns, but present some of the same challenges to suppliers as “Mom & Pop” stores.

#### **II.3. Import Distribution Channels**

Import and distribution channels in China very diverse and less than firmly established. The modernization of the retail sector is bringing on a parallel development of distribution infrastructure and logistics management systems. Graph 3 below is intended to give a diagrammatic and simplified impression of the flow of imported goods through a typical legitimate distribution channel. For more detailed information on the workings of import and distribution channels in China, please see Section I.5.



Source: (ATO Shanghai Research)

**Graph 3.** Import distribution flow chart

## II.4. Trends in Retail

The development of the retail sector in China is characterized by turbulent growth and fierce rivalry. The trends are pronounced and cyclical, starting with the birth of a great opportunity and ending in over-saturation and cut-throat competition. For example, department stores experienced a boom in the late 1980s and early 1990s, when everyone who had access to financing rushed to build one. By the late 1990s, they were driven into a corner by the rising power of modern Western-style supermarket chains. Now, hypermarkets and discount warehouse stores are forcing supermarkets to cut prices and consolidate to stay in business.

Below is a list of the latest notable trends in China's retail sector identified by ATO Shanghai:

- ! Hypermarkets are gathering all segments of food (and non-food) retailing under one roof, in a modern, clean, air-conditioned and user-friendly environment, while managing to keep prices low, thus attracting a growing number of loyal shoppers.
- ! Convenience stores are successfully filling the niche left by hypermarkets on the "local neighborhood" level.

- ! Branded chain stores (particularly among hypermarkets, supermarkets and convenience stores) are proving to be a successful marketing formula, commanding the lion's share of the market, and leaving virtually no room for independent operators.
- ! Supermarket chains (particularly medium and small stores) are feeling the heat from hypermarkets, and are consolidating, merging and branching into the hypermarket format in order to stay in business.
- ! Despite the onslaught of hypermarkets, big supermarkets are getting bigger and their per-store sales are rising; while sales at medium and small supermarket chains and independent stores has declined sharply (by as much as 50%) over the past four years.
- ! Foreign-invested and foreign-run chains (particularly hypermarkets) are riding the wave of modern retailing and are steadily eroding the market share of large state-owned Chinese retailers, who in turn are responding by consolidating and reorganizing their assets, and investing in modern facilities and managerial know-how.
- ! Availability of fresh fruit and vegetables; fresh, frozen and chilled meat and seafood; and ready-to-eat (RTE) foods, originally pioneered by foreign hypermarkets, is becoming the standard for supermarkets and even some convenience stores.
- ! Franchising by top-brand convenience store operators such as Lianhua to individual proprietors is a newly emerging trend, and one poised to eventually eliminate independent convenience stores and mini-supermarkets.
- ! Outdoor wet markets are on their way out, as municipal governments push to clean up the streets and regulate and tax all sales of food products.
- ! Convenience stores seem to thrive even in the vicinity of hypermarkets, as the large stores apparently generate more foot traffic than they take away.
- ! Hypermarkets and supermarkets still remain an urban phenomenon, with over 80% of all supermarket sales occurring in cities, more than half of which are in major municipalities and provincial capitals.
- ! Consumers continue to shop on a daily basis, keeping home food stockpiles to a minimum.

### III. COMPETITION

Food and beverage manufacturing and trade were among the first major industrial sectors in China to have their Communist-style state monopolies abolished, or at least marginalized, in the late 1970s and early 1980s. Since then, privately run cooperatives and individual proprietorships have become commonplace for, and even the driving force of, the sector. As a result, foreign-invested food manufacturing and retail ventures introduced modern technologies, new quality standards and the art of marketing. Now days, the China food industry is vibrant, sophisticated and characterized by fierce competition. This is most apparent in the food retail world.

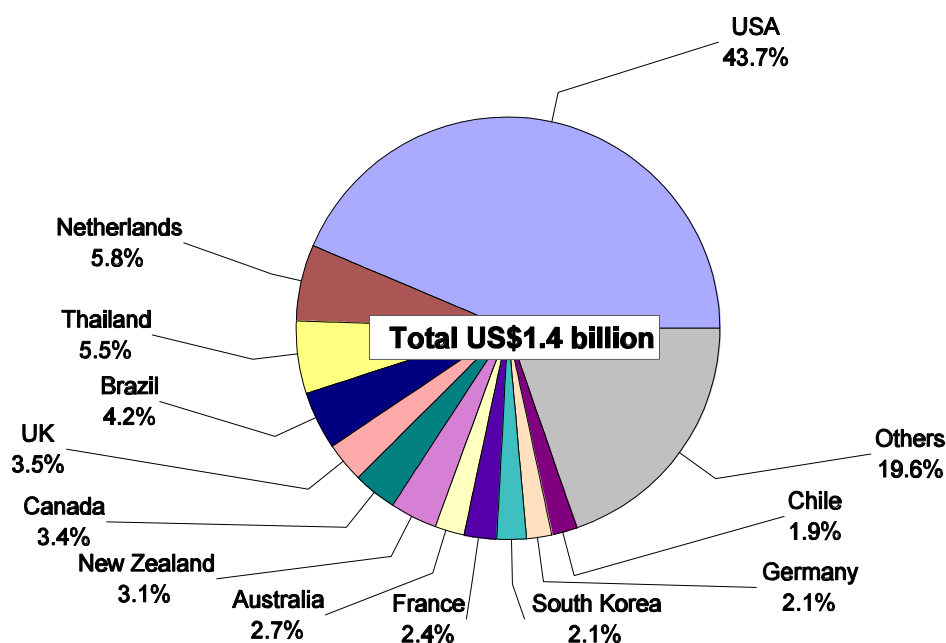
The most serious challenge facing US exporters is competition with Chinese or joint-venture counterparts. Domestically manufactured products dominate the food market scene, and for a number of dry-grocery categories (beer, carbonated soft drinks, processed meats, low-end confections/chocolate) have completely cornered the market, leaving very little room for imports.

In the categories where imported products are already prominent or even dominant (high-end or gourmet foods such as cheese, wine, fresh fruit, and breakfast cereal), competition is among the leading foreign suppliers. Few of these suppliers have permanent on-the-ground representation,

and their market penetration and marketing support often depends on the level of involvement or interest of their importer (usually a distribution agent or a big retailer). Nonetheless, at least in the following categories of imported products, leading exporter-countries have consistently managed to maintain a strong market share:

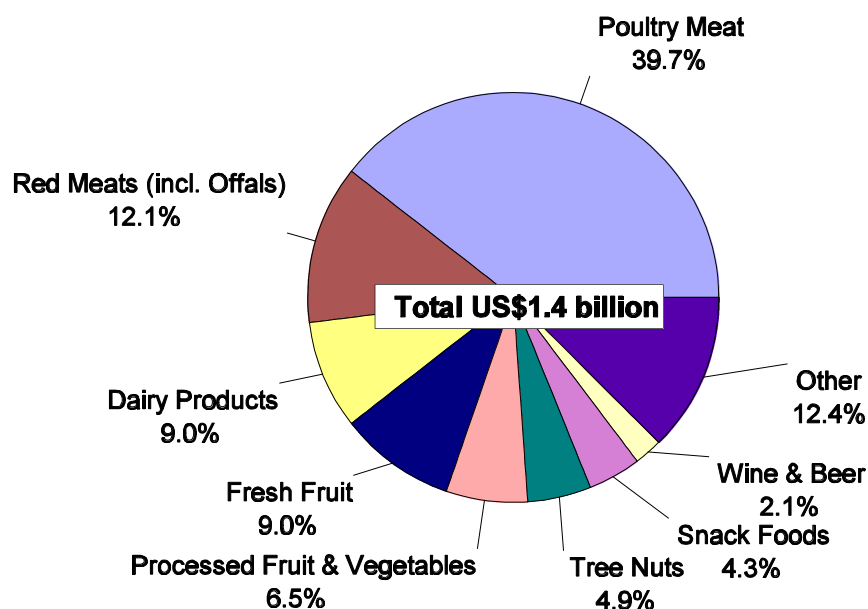
- ! fresh fruit: USA, New Zealand, Thailand, Philippines, South Africa
- ! beef: USA, Australia, Japan
- ! breakfast cereal: USA
- ! cheese: Australia, France (hurt by the BSE scare in the EU), USA
- ! french fries: USA
- ! fresh fruit: USA (citrus, apples, grapes), Thailand, South Africa, New Zealand (kiwi fruit), Philippines (bananas)
- ! poultry: USA, Brazil
- ! premium chocolate: Switzerland, Belgium, USA, Italy
- ! premium ice cream: USA
- ! seafood: Russia, Canada, Australia, USA
- ! tree nuts: USA (almonds, pistachios), Iran (pistachios), Turkey (hazelnuts)
- ! variety meats/offals: USA, Netherlands, Canada
- ! wine: France, Spain, Italy, Chile

**Graph 4.** Leading suppliers' share of 1999 re-exports to China via Hong Kong of consumer-oriented agricultural products.



(Source: Hong Kong External Trade Data)

**Graph 5.** 1999 re-exports via Hong Kong of consumer-oriented agricultural products originating from leading supplier countries.



(Source: Hong Kong External Trade Data)

#### IV. BEST PRODUCT PROSPECTS

Products in the market with good prospects:

- ! dried fruits and nuts
- ! confectionery
- ! snack food, cereals
- ! seafood (fresh, frozen, chilled)
- ! meat (fresh, frozen, chilled)
- ! fresh fruit, citrus
- ! vegetables (fresh and frozen)
- ! frozen foods
- ! milk powder
- ! infant formula
- ! pet foods

Products not present in significant quantity but with good potential:

- ! baby food (from fruit and vegetables)
- ! premium ice cream
- ! ready-to-cook (RTC) and ready-to-eat (RTE) foods
- ! private label foods and beverages
- ! cranberry juice
- ! fresh or frozen berries (raspberries, blackberries, blueberries)

Products which are present but have poor potential:

- ! beer – a very fragmented market, haunted by excess production capacity
- ! wine – considerable stockpiles of imported wines, no popular wine culture or palate yet
- ! soft drinks – market cornered by Coke and Pepsi
- ! canned meat and fish – not considered fresh or appetizing

## V. POST CONTACT AND FURTHER INFORMATION

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For further information about exporting to China, as well as upcoming events and activities, please visit the ATO Shanghai website [www.atoshanghai.org](http://www.atoshanghai.org). Among the many reports available on the ATO Shanghai website are two that are recommended for first-time exporters to China: *Exporter Guide, China* (CH9830) and *Business Travel in China* (CH9818). Reports from ATO Shanghai and other ATO offices around the world are also available from the FAS website [www.fas.usda.gov](http://www.fas.usda.gov).