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Voluntary Public

Date: 6/15/2012

GAIN Report Number: 12806

China - Peoples Republic of

Post: Shanghai ATO

China Retail Report

Report Categories:

Retail Foods

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Report Highlights:

In response to rising inflation and food safety concerns Chinese are cutting back on eating out and are now cooking more and more at home. Consumers of imported food are generally expatriates and high and upper –middle income locals. Consumption of western style products continues to grow as they generally are regarded as good quality, nutritious and safe. Some products, such as fresh fruit, dried fruits and nuts, have much deeper penetration, and some supermarkets and convenience stores are becoming more interested in a wider variety of imported products. With increasing household incomes and food safety concerns, more middle class consumers are trading up to buy imported grocery products.

Executive Summary

In response to rising inflation and food safety concerns Chinese are cutting back on eating out and are now cooking more and more at home. Consumers of imported food are generally expatriates and high and upper –middle income locals. They are least affected by inflation and pay great attention to food safety. Consumption of western style products continues to grow as they generally are regarded as good quality, nutritious and safe. Some products, such as fresh fruit, dried fruits and nuts, have much deeper penetration, and some supermarkets and convenience stores are becoming more interested in imported products. With increasing household incomes and food safety concern, more middle class consumers are trading up to buy import grocery products.

International hypermarket retailers generally have a high level of familiarity with imported brands and products, and recognize the value of bringing new products to market. Hypermarkets frequently source high-volume merchandise directly from manufacturers but rarely do so with imports. However Metro, the German Cash & Carry Chain, is an exception. It has implemented a direct import policy and upgraded its Shanghai sourcing department to purchase products for all of Asia – including China, Vietnam, India, Pakistan, Japan and Indonesia. Hypermarkets in China tend to develop groups of favored distributors. They dislike working with unfamiliar companies unless they can offer a large number of products, strong marketing support, or some other incentive.

Internet retailing is growing rapidly in China. And many international retailers have entered internet retailing directly or indirectly. Wal-Mart launched an internet retailing site for its Sam's Club chain in 2010 <http://www.samsclub.cn/sams/homepage.jsp>. More recently, Wal-Mart agreed to increase its stake in the rapidly growing domestic online supermarket www.yihaodian.com to 51%. However, the deal has not yet been approved by Chinese authorities. In addition to the large number of domestic online retailers, the following international retailers currently have online operations:

Carrefour <http://e-shop.carrefour.com.cn>.

Auchan: <http://www.auchan.com.cn>;

Metro: www.sssclub.cn (products are exclusively provided by Metro)

Lotus: [卜蜂莲花 \(易初莲花 \) 购物网站 - - - 品位生活服务到家](http://www.lotus.com.cn)

Sam's Club: <http://www.samsclub.cn/sams/homepage.jsp>.

Specialty supermarket stores include stores targeted at expatriates, upscale and upper-middle Chinese consumers. There are also specialty supermarkets that focus on shoppers that want organic foods, wine, cheese and similar high-end products. These stores have proliferated in recent years, not only in first tier cities such as Shanghai or Beijing but also in some second tier cities. Originally designed for expatriates, these stores are becoming more and more popular by Chinese consumers. Some stores market more than 70-80% imported goods.

Retail distribution channels have not grown to match the number and quality of retail outlets. China does not have a nationwide network of trucks, highways and cold storage warehouses that can efficiently deliver supplies from the manufacturer or importer to the store shelf. A lack of appreciation for the value of maintaining the cold chain creates special problems for temperature sensitive items. With some notable exceptions, distribution is handled on a store-by-store or city-by-city basis, with stores receiving most imports through a local distributor, often even when alternatives exist. Because of their relative size, stores are able to effectively pass all market risk onto the distributor. Distributors, in turn, tend to

be very conservative about new products. If goods do not sell, the distributors are unable to return imported products.

Distribution varies widely throughout China based on geography, product type and retail sector. As a general rule, the three cities of Shanghai, Guangzhou and Beijing have the best infrastructure and the largest number of experienced distributors. Increasingly, those systems are being extended to the large webs of satellite cities surrounding Guangzhou, Shanghai and Beijing. Other major cities along the eastern seaboard, beyond the reach of the 'big three,' generally have good logistics infrastructure, but most still rely on one of the 'big three' as an entry point for imports. Farther inland, there are a number of large cities with good market potential. Logistics can be problematic, but improvements in the national highway system have made trucking direct from Shanghai or Guangzhou far easier than it was just a few years ago. As a result, high value and temperature sensitive products shipped by truck directly from the importer to a local distributor do surprisingly well. Currently, many secondary cities have only a few distributors for imports, particularly for high-value or temperature-sensitive products. Multi modal refrigerated rail transportation to inland cities may become viable over the next several years. Several international companies are currently developing local partnerships to create modern cold chain and distribution systems across China.

The most serious competition for U.S. food exporters comes from local and joint venture food producers and processors. The quality of fruit and vegetables in particular has increased rapidly, and many local traders now contend that the best of China's fruit is similar in quality to imports. While some firms are trying to lower the price of imported products, the general trend to date has been for local manufacturers to push imports out of the price-driven mass market and into niche markets where quality and novelty are more important than price. The United States remains the largest single exporter of consumer-oriented food to China, and is the only exporter with a presence in most categories.

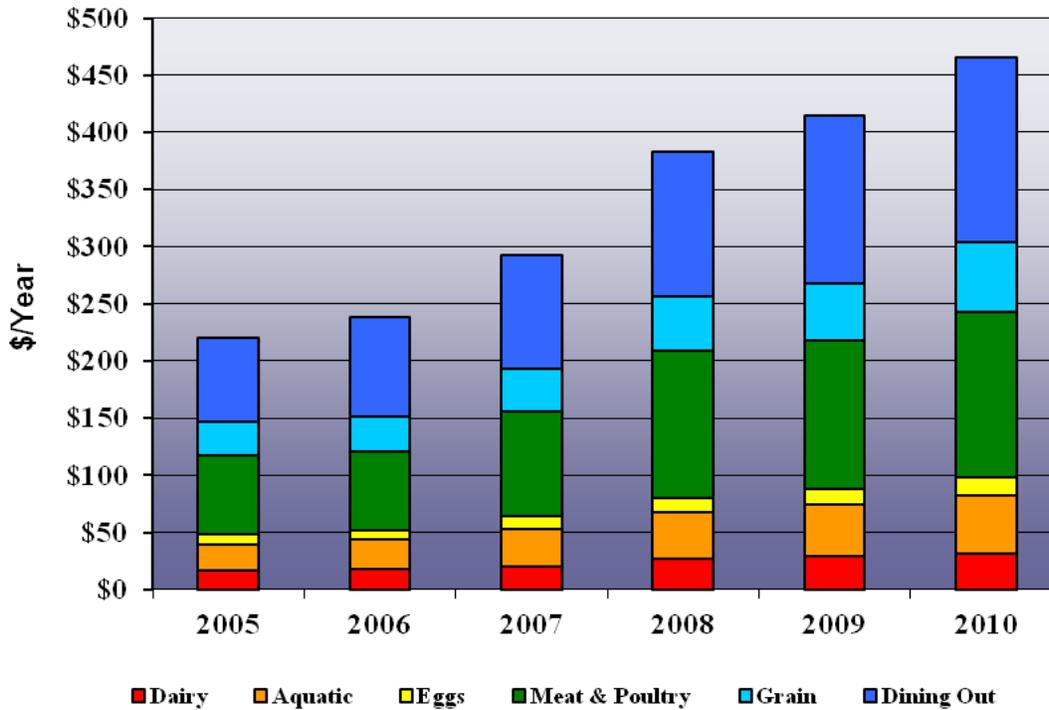
China is not a single market but a jigsaw puzzle of small, overlapping markets separated by geography, culture, cuisine, demographics and dialects. As such, there is no single formula for success in China. The fragmented distribution and logistics systems help to reinforce existing divisions. While smaller emerging cities are still relatively small consumer markets compared to Shanghai, Beijing, and Guangzhou, they are generally growing faster than the major markets and many would be considered large cities in countries other than China and India.

Consumer Spending Patterns

In responding to rising inflation and food safety concerns, Chinese are reducing the number of times they eat out each week and are cooking more often at home. Imported food consumers are generally expatriates, and high and upper –middle locals. They are least affected by inflation and pay great attention to food safety. Consumption of western style products continues to grow as they generally enjoy a reputation for good quality, and being nutritious and safe. a series of food scandals disclosed by local media from steam buns, hot pot seasoning, milk powder, edible oil, frozen dumplings to rice and egg, more local consumers are buying imported food products due to health and food safety concerns. Convenience is also an import factor due to increasingly fast paced lifestyles. Chilled processed food and frozen processed food will see relatively rapid growth in the near future. As a result of the

melamine contamination scare, many consumers in China switched to soy milk or soy drink as an alternative dairy protein source.

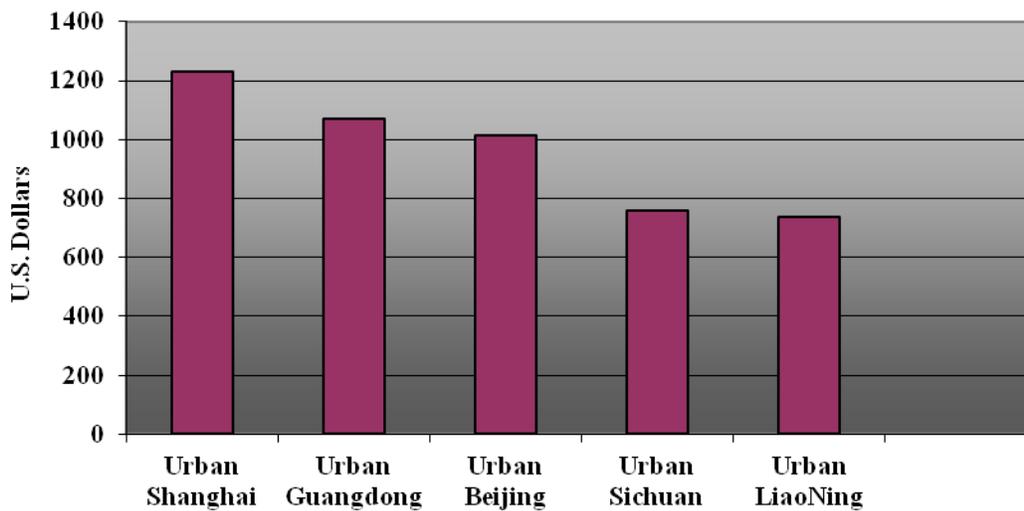
Spending on Food in Urban Areas Per Person, Urban area Average



Source: China Statistical Yearbook 2011

Strong and continuous economic growth caused urban Chinese to increase their spending on food by almost 1.1 times from year 2005 to 2010 when measured in U.S. dollars. While average annual food purchases for all cities was slightly more than \$700 per year, per person food consumption in Shanghai was slightly more than \$1,200 per person, and that in Beijing and Guangdong was about \$1000 per person. This compares with U.S. food purchases per person of about \$2,300/year. Urban food purchases per person in Sichuan, a province in Western China that contains the city of Chengdu, come in at the national average for urban areas - demonstrating the potential of markets in western China. While there are some smaller cities where per capita income is about equal to that of Shanghai (such as Ningbo), the population and wealth of the three largest urban areas - Shanghai, Guangdong, and Beijing - lead most exporters to concentrate on at least one of those markets.

Annual Purchases of Food in Selected Areas Per Person in 2010



Source: China Statistical Yearbook, 2011

China is a very large country and different parts of China are at different levels of development. However, there are large variations of income and pockets of wealth in all large urban areas, and Chinese cities are no exception. The wealthiest areas in China are Beijing and Tianjin in the north, Guangdong and Fujian in the south, and the Shanghai, Jiangsu, Zhejiang area in eastern China.

There are many urban centers in China that westerners have not heard of. Even a "small" city by Chinese standards may have millions of people. These are becoming much more prosperous, and their growth rates are starting to exceed those of the three large urban areas. It would be a mistake to overlook these markets and the potential to develop strong market positions in them. While there are certainly opportunities in these secondary markets, the number of distributors handling your type of product may be very limited. Given differences in regional tastes, logistical difficulties, and the size of China, many exporters choose to focus in a particular region of China first rather than try to develop the entire market at once. The Chinese Central Government is promoting aggressive policies to develop these interior regions and many multinational companies are racing to establish an early presence in many of these major urban centers. Opportunities are waiting to be found, but require resources and patience.

Market Size and Segments

Determining the size and rate of growth of Chinese retail market is complicated. The official data does not attempt to pick up the smallest enterprises, and the usual concerns about data quality in a developing country are compounded by China's legacy of central planning. The Yuan also keep appreciating against the U.S. dollar. This gave an added boost to Chinese expenditures when measured in dollar

terms. According to China Ministry of Commerce, China's retail sales may grow 15 percent annually through 2015 and top 32 trillion yuan (USD5 trillion) in 2015.

Market Segments

Retailers in China often cross several market segments. Some domestic players have hypermarkets, supermarkets, convenience stores, and specialty stores. However, we can say that most imported products have found their greatest success in the hypermarkets and in specialty supermarkets. Some products, such as fruits and snacks, have much deeper penetration, and some supermarkets and convenience stores may be becoming more interested in imported products.

Hypermarkets: The hypermarket format is much more concentrated than other grocery channels. While some domestic retailers (including CRV-China Resources Vanguard and Lianhua) have a significant presence, this format is dominated by foreign operators including Carrefour, Wal-Mart, Metro, Lotus, RT-Mart, Auchan and Tesco. In Shanghai for example, the 82 foreign hypermarkets accounted for 78.6% of the total hypermarket sales volume in 2008. Other retail channels, most notably supermarkets, are highly fragmented and controlled by domestic players.

With the strong and sustainable development of China's macro economy, the urbanization process continued its stable growth, and hypermarkets benefited from the urbanization trend. In contrast to people in rural areas, urban inhabitants are more willing to buy branded daily necessities from well-known hypermarkets, supermarkets and shop in department stores, rather than purchase products through traditional channels such as independent small grocery stores (xiao mai bu) or wet markets. Consequently, hypermarkets/supermarkets, particularly well-known names such as Carrefour, RT-Mart, Auchan and Wal-Mart, recorded higher value growth than independent small grocers, thanks primarily to the urbanization trend.

In addition, they also benefit from their reputation for offering better quality products than most domestic retailers, thanks to stricter quality control in a country where food safety is a major concern after several disturbing food scandals in recent years. In food products, especially fresh food, hypermarket retailers benefit from better hygiene controls and a higher volume flow rate, and are thus able to ensure better food safety for consumers. As such, an increasing number of Chinese consumers visit hypermarkets instead of independent food stores for grocery shopping. The proportion of grocery products in hypermarkets continues to increase, rising from 54% in 2005 to 60% in 2009. As a result, hypermarkets are trying to provide more food categories in order to meet the demands of consumers. Among them, fresh produce has become an attractive section to draw in Chinese consumers.

International retailers generally have a higher level of familiarity with imported brands and products, and recognize the value of bringing new products to market and promoting them. Hypermarkets are also the major sales venue for imported food products, due to international retailer's familiarity with

imported products and better management and organization skills. Most are experienced in promoting new products, and Shanghai flagship stores like Carrefour's Gubei store or Lotus' Superbrand Mall store in the Pudong area have it down to a science. Despite this, imports rarely constitute more than 5% of total SKUs even in high profile stores. Nevertheless hypermarkets are the single best retail venue for imported products.

Most hypermarket chains vary the proportion of imported goods they carry in individual stores depending on the income level and foreign population that the store serves.

Meanwhile, the urbanization trend in lower-tier cities has also stimulated leading retailers' expansion into less developed regions, to seize the opportunity in second-and third tier cities.

The hypermarket has been well accepted by affluent customers due to large parking facilities, multiple stores and numerous restaurants and coffee shops that enable consumers to combine shopping and leisure activities. Most hypermarkets in China offer free shuttle bus service to nearby communities and constantly offer promotional items to attract consumers. These measures successfully draw heavy traffic to the store, but some consumers go to the store to buy the promotional items only, reducing the purchase per customer. This active promoting may also drive away some high-end consumers who desire a less crowded environment and more concentrated product display. As a result, specialty supermarket stores such as City Shop in Shanghai and China Resources Vanguard high-end retail format Ole, both targeting high and upper-middle class clients, have successfully attracted customers from the hypermarkets.

The most decisive component in hypermarket food promotion for imported goods is free sampling. Consumers are cautious rather than impulsive buyers, and will rarely spend money on a product they have not had a chance to try. Hypermarket promotions also come with many strings attached. Some charge listing fees, most demand that promoters be provided at the distributor's expense (some even charge fees to have the promoters on their premises). Some require two months' credit, while others pay up front. Other conditions include accepting returns of unsold products at the end of the promotion. Although these problems are usually handled by the distributor, they will affect your sales.

Towards the phenomena of retailers charging various fees to distributors, on Dec/19th 2011, five ministries and committees in China issued the joint plan about regulating big retailers charging fees towards suppliers, the nation-wide regulating period is from Dec 2011 till June 2012. In this plan, only promotion fee is allowed, all other fees such as delivery fee, slotting fee, holiday fee, new store opening fee, sales check and new account opening fee etc are illegal, not allowed to charge. This new regulation caused a lot of argument and confusion, thus till now most retailers which are supposed to already signed their contracts with suppliers have not done so yet, most retailers and suppliers just unanimously followed last year contract. The nature of this regulation is supposed to protect the interest of small and medium sized suppliers and regulate retailers' behavior about over-charging suppliers, but just cutting off all the other fees arbitrarily caused huge argument among retailers. For instance, in order to streamline the logistics, most retailers built their own distribution centers, thus suppliers don't need to send goods to every store and instead just send to distribution center of retailers. Retailers are responsible for delivering to stores and they charge a delivery fee to suppliers. But according to the new

regulation, it's illegal to charge such fee now. Even for the allowed promotional fee, there is area unclear. Because retailers usually charge different level of promotional fees based on the store location, right now do they need to charge the same level of promotional fees regardless of stores location? With all above said, retailers don't know what words to put on contract and what not.

In addition to the major chains, hypermarkets often face competition (especially in Northeast and Central China) from local department store operators with one or two locations and specialty supermarket stores. Department stores have evolved in the direction of hypermarkets, adding large food stores, while many hypermarkets have taken on some attributes of department stores.

Hypermarkets in China tend to be somewhat smaller than their western counterparts, and very few (excepting Metro) follow the big-box format faithfully. In large cities, they are typically multi-story operations. Most act as small shopping malls, setting aside a large amount of space for independent boutiques and eateries, a habit that tends to reinforce the perception of hypermarkets as places for occasional shopping expeditions rather than daily shopping. For the hypermarket itself, the food sales area typically accounts for about half of the total area.

Management within the stores tends to be quite good, but distribution has not kept pace. Hypermarkets in China tend to develop groups of favored distributors. They dislike working with unfamiliar companies unless they can offer a large number of SKUs, strong marketing support or some other incentive. Distributors tend to be very conservative in introducing new products, due to the high level of market risk. As a result, exporters with a limited product range need to work both ends of the problem at the same time: identifying a retailer that is interested in the product, and identifying a distributor that either has an existing relationship or is willing to work with the retailer.

Supermarkets: Domestic players dominated in supermarket sector. Companies like Lianhua, China Resources Vanguard, and Suguo are the major players in the market. But it's still quite a fragmented market; there are a large number of regional small chained or independent supermarkets in the country, especially in many second and third tier cities. But some international retailers have started to enter this market in recent years. For example, Tesco launched a new brand called Tesco Express in mid 2008 in Shanghai, which was designed as an outlet mainly selling fresh food and daily supplies to nearby communities. In 2009, Wal-mart also opened its neighborhood market outlets. Post believes more international retailers will enter this market in the future.

Imported food is relatively rare in Chinese supermarkets. Products that do well in this sector tend to be commodity products already widely available, such as fresh fruit, frozen vegetables and nuts. Supermarkets rarely if ever import directly, or even buy directly from an importer, tending instead to rely on wholesale markets and local manufacturers or distributors. Stores with a significant expatriate community nearby are likely to carry imported breakfast cereals and a perfunctory selection of imported sauces (especially pasta sauce) and seasonings. The best possibilities are in the smaller, privately held chains, which are more likely to see the value of high-margin imports and tend to have better integrated

distribution systems. Such chains may carry products as varied as wine, exotic fruit (avocados, in one case) or confectionery, but only in low volumes and on an irregular basis. Even so, price will remain a consideration. State-owned supermarket chains generally have less integrated management and distribution. Opportunities exist, but only on a limited basis with a small number of stores, and only for products already present in the market. For either state-owned or private supermarkets, direct contact with company managers is the best means of introducing a new product.

Import penetration is lower in supermarkets than other modern retail venues. U.S. food products in these venues are typically limited to frozen corn and mixed vegetables, frozen potato products, some packaged goods and occasionally fruit (apples or oranges). Other items tend to appear on a haphazard basis: past checks have turned up breakfast cereals, low-end wines and Washington state apples. The sparse selection of imports is rooted in the customer base of these stores, which focus on working class shoppers, who are notoriously price sensitive and less inclined to try new products than the more well-heeled customers that frequent hypermarkets and upscale convenience stores. Distribution is also a problem, as stores tend to source from local distributors, directly from manufacturers, or from local wholesale markets. Supermarkets are often franchised in China and can have much smaller footprints than is common in the United States.

In order to compete with hypermarkets, Shanghai's supermarkets are putting more efforts into enlarging their fresh section, catering to the tastes and demands of local consumers. The local government is also encouraging supermarket chains to create 'fresh' supermarkets, expanding the floor space dedicated to fresh products from less than 1/3 to over 1/2. Over 300 stores in Shanghai have finished the change. And sales of fresh produce are gradually increasing. Supermarkets throughout the region (including Suguo, a unit of CRV) appear to be moving in this direction, but are being slowed by problems in sourcing large quantities of quality product. This could also indicate trend away from low cost, traditional "wet markets" which are often unable to match hygiene standards of supermarket/hypermarket chains. However wet markets still dominate sales of those fruits and vegetables.

Specialty Supermarket Stores and Boutique stores: These stores have multiplied in the last few years. They are often located adjacent to high-end department stores or upscale business centers. Built to attract upscale consumers in first and second-tier cities, they have a high proportion of imported food products – ranging from 10 to 80 percent of products. They are not only present in first tier cities such as Shanghai but also in some second tier cities like Suzhou, Hangzhou or Wuhan.

Some high-end and specialty products first enter the Chinese market through these types of outlets before moving on to larger venues. Some of these companies also include import/distribution operations, and can assist exporters with issues such as labeling and product registration. Otherwise, exporters will need to identify a good distributor. In the case of high-end and specialty products, HRI-focused distributors (who are familiar with the products but may lack experience with labeling issues) may be as helpful as larger retail-oriented distributors (who often lack experience marketing high-end

products), particularly in emerging city markets. Because of the small scale and highly varied nature of this market segment, interested exporters should contact the relevant ATO for a list of potential venues and importers/distributors. China is well covered with ATOs in Beijing, Chengdu, Guangzhou, Shanghai and Shenyang.

In Shanghai, many retailers have entered this sector to capture opportunities. City Shop Supermarket continues to be one of the best single venues for imported food, and now does significant business as a distributor of imports to other stores. Hong Kong based City-Super opened its first outlet and CRV's Ole opened four stores in Shanghai with another two in Hangzhou and Ningbo respectively.

In addition, some food importers down-integrated their business and opened their own import products stores. Also people from other businesses either in export or real estate also entered into import food business or opened their independent import products stores in Shanghai. Products assortment, price and consumers shopping experience are key to be successful in this segment.

The leading boutique retailers in northern China are BHG (Beijing Hualian Supermarket) and Ole in Beijing, Hisense Plaza in Qingdao and Jin Bou Da in Zhengzhou. Specialized imported food supermarkets also target high-end customers and expatriates in Beijing, Qingdao and Zhengzhou. BHG has several stores in Nanjing.

Convenience Stores: Management in convenience store chains is probably the best of any retail sector. All stores have refrigerator and freezer sections, microwave ovens, and most have a selection of hot snacks (mostly meatball, tea eggs or tofu on skewers). Store layouts are highly standardized, although some chains have developed more complex systems that customize product selection to the peculiar location based on past sales patterns, and neighborhood income levels/spending habits. Stores are providing more and more services of “convenience” such as payment services and delivery services.

The concept of trading higher prices for convenience will take time to be accepted by Chinese consumers. Competition also tends to make convenience stores conservative about pricing, though ATO Shanghai's experience indicates that chain managers are more price sensitive than their customers.

The convenience store sector is relatively saturated in major cities especially in Shanghai. It is said that the average number of convenience stores per thousand people in Shanghai is even higher than the number in many developed countries. However, International brands still wants to gain a foothold in this highly populated and prosperous market in China, 7-Eleven, the World' largest convenience store chain, entered the market in Shanghai in 2009, and is very strong in South-China.

Import penetration in this sector tends to be relatively low, despite a high level of interest on the part of several chains. Being largely domestic companies, management at convenience store chains tends to be less familiar with imported products than their counterparts in the hypermarket sector. A second difficulty faced by imports is packaging: convenience stores typically require smaller package sizes, being focused mainly on single-serving products. However the foreign players in the market, such as 7-Eleven and Family-Mart, have introduced more imported products into their stores. But these are mainly

from Japan and south-east Asian countries. Exporters are advised to open discussions directly with chain officials to identify products with potential, and ensure that packaging meets their needs.

Then the exporter will need to identify a local distributor that can handle the import paperwork and labeling issues. One alternative to this is to work with an importer/repacker, who can import in bulk, then package the products in China with Chinese labels and packaging appropriate to the convenience market. This strategy has proven extremely successful for U.S. prunes. One U.S. distributor in Beijing is directly importing products from the U.S. and is managing his own paperwork and packing.

Managing logistics for convenience stores is very challenging. Limited shelf and storage spaces make convenience stores heavily reliant on sophisticated logistic systems that should provide delivery 2 or 3 times a day. But in Shanghai most convenience stores are guaranteed just one delivery per day. This adversely affects the ability of these stores to offer the fresh and ready-to-eat products that are among their most attractive offerings. In addition, the need for small package sizes limits their set of suppliers.

Traditional Markets: These continue to be a presence throughout China, although they are no longer the dominant factor in the larger cities. Traditional markets fall into three general categories: wet markets, variety stores (xiaomaibu), and fruit stands. Wet markets specialize mainly in fresh vegetables, meat, poultry and seafood (Mostly sold live), eggs, tofu and to a lesser extent, fruit and staple foods. Sanitary standards are extremely low, particularly for meat. Officials generally regard wet markets as an eyesore, as well as a source of both food safety problems and unregulated (i.e., untaxed) commerce. The SARS epidemics of 2003, followed shortly by avian influenza outbreaks, provided more impetus to efforts to reform or close these markets. Nonetheless, they persist. The main reason for this is a lack of alternatives for buying fresh vegetables and, to a lesser extent, meat. With local government support, however, supermarkets' efforts to expand the fresh section, and especially with consumers' growing concerns over food safety, these traditional markets will gradually be phased out.

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

Fruit stands fill another gap left by the convenience stores, which rarely carry more than one or two types of fruit. Sales are boosted by the tradition of giving gifts when visiting friends, and most fruit stands will wrap fruit baskets to order. Fruit stands frequently carry imported fruit, usually for inclusion

in fruit baskets. However, they are generally regarded as poor venues for imported products, as they are generally price driven, poorly regulated and lack the means to store fruit properly. Counterfeiting is widespread in these markets, and where a brand name adds value, it is certain to be copied. As a result, there is little room for marketing and promotion of imported products. While both xiaomaibus and fruit stands will likely continue to decline in numbers relative to convenience stores, China's high urban population densities are likely to support their continued existence for many years. Recently, there are new companies engaging in on-line sales of high quality imported fruits with next day delivery as incomes rise and internet usage increases, online sales may become good alternative to traditional fruit stand sales in the future.

Product Distribution

Retail distribution channels have not grown to match the number and quality of retail outlets. Roughly the size of the continental United States., China does not have a nationwide network of trucks, highways and cold storage warehouses that can efficiently deliver supplies from the manufacturer or importer to the store shelf. With some notable exceptions, distribution is handled on a store-by-store or city-by-city basis, with stores receiving most imports through a local distributor, often even when alternatives exist.

Because of their relative size, stores are able to negotiate highly favorable terms that include free return of unsold products, high listing fees for new products (uncertain at the moment, as according to the new regulation, all such fees are illegal), and credit terms, effectively passing all market risk onto the distributor. This gives store managers a powerful incentive to favor the local distributor over alternatives that offer less generous terms. In at least one case, an international retailer's effort to establish single-desk distribution of imports failed when their own stores refused to work with the selected distributor.

A second reason for reliance on local distributors is the tendency of international retailers to expand rapidly nationwide rather than focusing on a single city or region, creating large numbers of isolated stores that lack the volume to support a dedicated distribution network. A final reason has to do with the role of relationships in Chinese business: local distributors can provide a store with a network of business and government contacts that are useful in resolving problems with minimal fuss.

Fragmentation among suppliers of locally sourced products, particularly of vegetables and meat, helps to perpetuate the dominant role of the local distributor. This is changing slowly, as the government encourages direct sourcing and farmers' professional associations become more common, giving producers the ability to supply larger quantities from a single source and at a more consistent level of quality.

International retailers have recognized the problem and put a greater effort into improving the logistics system. Right now, Wal-Mart is focusing on building a nationwide distribution network, and has a recently built distribution center in Tianjin. The German retailer Metro has a centralized distribution

system for many imported products, and a few large distributors have negotiated more favorable terms with retail chains at the national level, in some cases waiving listing fees. Carrefour also contracted with a third party logistics company to handle most of its imported grocery items. Tesco also can provide national distribution and purchasing. But fresh and frozen items still rely on importers or distributors to deliver to the stores themselves. The role of the local distributor in handling imports is declining. Nonetheless, for now, distribution remains the key obstacle to sales of imported processed foods in China's retail sector.

Because of the high level of risk they are expected to absorb, distributors tend to be very conservative about new products, particularly imports. As a result, penetration of imported foods into the retail sector is low. Even in relatively affluent cities, international retailers typically carry less than 1% imported SKUs. Notable exceptions include stores in Shanghai, Beijing, Guangzhou and nearby boomtowns, which are home to both large expatriate communities and to a large number of Chinese with overseas experience. Products that are already in the market but being sold mainly through gray channels or sub-distributors tend to be the most attractive to distributors. However, these products are most likely not labeled properly and are not available in market on a consistent basis.

Farther inland, distribution problems are complicated by China's heavily fragmented logistics systems, which makes it difficult to transport products directly from the coast to deep inland cities. One survey in Chengdu found that temperature sensitive items, such as imported poultry and meat, changed ownership as many as five times within China before reaching the final user.

A lack of appreciation for the value of maintaining the cold chain creates special problems for temperature sensitive items. Even if cold storage is used at the port of entry and the retailer maintains the appropriate environment, getting drivers to maintain the correct temperature during transportation has proved difficult. While this is certainly true in secondary markets, where frozen products often have a frosty covering, it is also true in the major coastal markets.

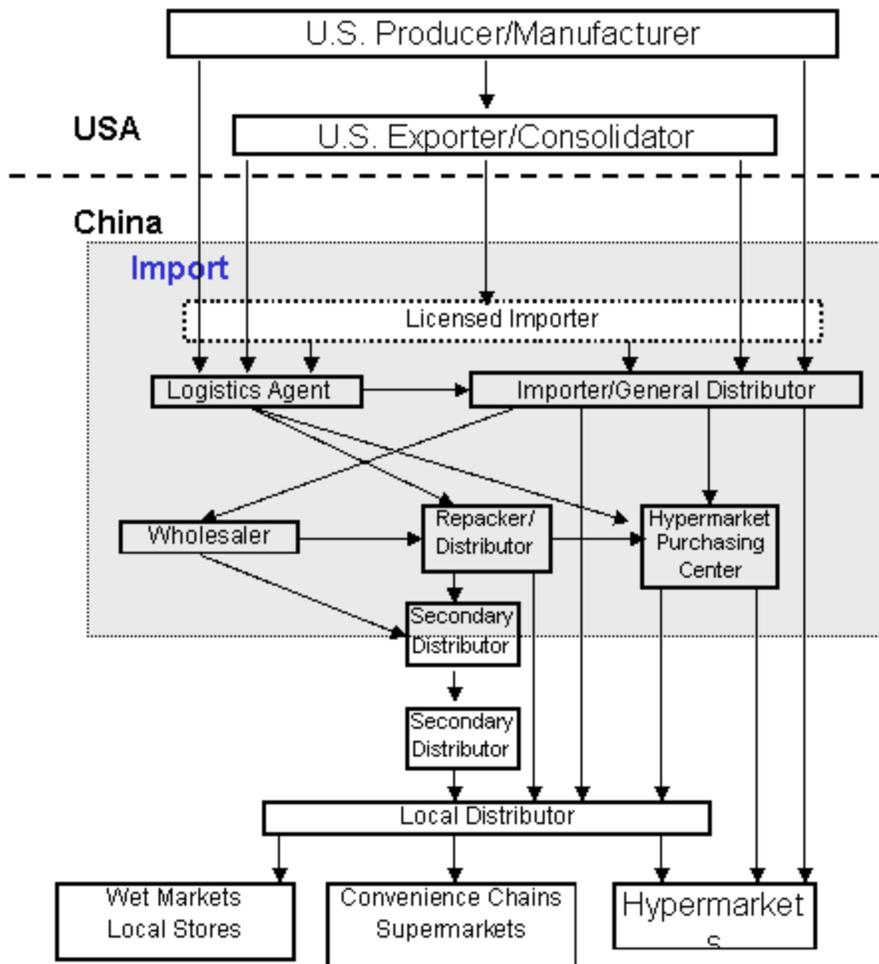
Distributors generally fall into one of two categories. The largest distributors tend to have longstanding relationships with the major retail chains, and can source in larger volumes and place products in a larger number of stores. However, they also tend to carry a large number of SKUs, and cannot dedicate resources to marketing any one particular item. Specialty distributors tend to be focused on one area or product type. Although they sometimes lack the volume and connections of larger distributors, they tend to be more aggressive in marketing products and better at identifying and selling into specific niches. The quality of these smaller distributors varies widely, however, and exporters need to be very careful in selecting a partner.

A handful of retailers also act as distributors. Although they tend to provide less marketing support, they can be an effective means of getting product to retailers that have already expressed an interest, but cannot handle the import formalities themselves. One major importer in Shanghai who is familiar with several large grocery consolidators in the United States has opened two retail outlets showcasing these

products, one in Nanjing in Central China and the other in Tianjin in China's northeast coast. The company distributes products to specialty stores as far west as Lanzhou and Kunming and hopes to buy certain snack foods directly from U.S. manufacturers in the future.

Geographic Differences in Distribution

Chinese Distribution Channels



Source: ATO/Shanghai research

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

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

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

Distribution by Product Type

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

New Trends in Retail

Internet retailing –As a newly emerging channel in retailing, internet retailing has experienced explosive growth in China. Product comparisons and price comparisons are just a click away. Products sold in online shops are usually cheaper than in store-based retailers. And competitive price is an important factor which draws Chinese consumers, who are mostly price-sensitive.

Taobao.com, owing to its early entry into internet retailing, now is the No.1 player in China. 360 buy.com, starting as a consumer electronics and appliance specialist, now has evolved into an online shopping mall, covering a wide range of consumer products including food products.

To exploit the lucrative internet retailing channel, many store-based retailers have gone online. Wal-mart became a minority shareholder in the rapidly growing domestic online supermarket www.yihaodian.com in 2011. The latest news is that Walmart just increased its shareholding in Yihaodian to 51pct and thus became a majority shareholder, but such deal is not approved officially by Chinese authority yet. Carrefour, Metro and Lotus etc all entered into internet retailing directly or indirectly.

Direct sourcing of food and agricultural products from farm cooperatives has been adopted by many retailers in Shanghai and is growing elsewhere. This allows retailers to address consumers' concerns about food safety, reduced cost, and possibly improve product quality. On the imported product side, more and more retailers especially those in the specialty supermarket section are looking for direct sourcing channels. But not all of them are successful. Post heard from industry that one high-end retailer in Beijing purchased a consolidated container of goods directly from the United States and ended up selling at a heavy loss, due to product selection problems. International players have also moved in this direction. Wal-Mart started to directly source and import U.S. cherries. Metro goes ahead of others and moves seriously towards directly import by upgrading its Shanghai sourcing department to its Asia sourcing center, and be responsible for sourcing products not only for China market but also for India, Pakistan, Japan, Vietnam and Indonesia etc.

Private label products are a new development in China. Each hypermarket, supermarket and convenience store chain in China has a unique private label offer: Carrefour, Great Value, Metro's IKA, Tesco and Lianhua are private label lines from leading players. In terms of imports, more private label products are coming on the market here. Metro has moved ahead of the pack in this regard - it imports salmon from Norway by itself, and then packs it and sells in under its private label brand IKA. Import private label is expected to see more dynamic growth, thanks to the focus on private label lines by retailers in their pursuit of higher profit margins.

Several **specialty wine retail** outlets have opened in Shanghai. These sell a selection of imported and domestic wines and are not to be confused with state-owned liquor and tobacco stores. The most notable is Napa Reserve, which features a wide range of wines from that region of California. The Chinese wine market is more completely analyzed in the National Wine Market Report [CH12805](#).

Retailer Profiles

Domestic retailers generally have an advantage over foreign retailers, and China is not an exception to the rule. China Resource Vanguard and Lianhua are the largest food retailers in China. While the sales volume of the three largest multinational chains – RT-Mart, Carrefour, and Wal-Mart – are quickly catching up. If you look at sales per store, foreign retailers are definitely way ahead than domestic retailers. Most of the Chinese domestic retailers focus on a clientele that is more representative of the Chinese population than that of the multinational retailers. They also have store base that is often older, partly franchised, and has large numbers of smaller properties.

While the domestic retailers are becoming more interested in imported products, importers have traditionally focused on, and gotten better results from, the multinational hypermarket retailers. The number of hypermarkets by retailer in selected cities and the total number of stores by retailer in Shanghai are presented in the appendix.

The table below gives a snapshot of the relative competitive position of some of China's leading food retailers. The data is for the year ending December 31, 2010.

Leading Food Retailers in China: 2010				
Company	Ownership	Business Line	Stores	Sales* ¥ billion
Chinese				
Lianhua	China SOE**	Super/Hypermarket/ Convenience	5239	70.0
Wumart	China Pvt	Supermarket/ Convenience	2578	38.0
Suguo (CRV)	China SOE***	Supermarket/ Convenience	1905	37.0
Nonggongshang	China SOE	Super/Hypermarket/ Convenience	3204	29.0
Vanguard (CRV)	China SOE	Super/Hypermarket/ Convenience	3155	72.0
Multinational				
RT Mart	France	Hypermarket	143	50.0
Carrefour	France	Hypermarket	182	42.0
Wal-Mart	U.S. JV	Hypermarket	219	40.0
Metro	Germany JV	Hypermarket	48	12.0
Tesco	U.K. JV	Hypermarket	109	16.0
Auchan	France	Hypermarket	41	13.5
Lotus	Thailand	Hypermarket/Convenience	74	13.6
* Food and non-food sales				
** SOE= State-Owned Enterprise				
*** Joint venture with China Resources Vanguard				

Source: China Chain Store & Franchise Association 2010-2011

Hypermarkets

RT-Mart was the number one company in the Hypermarket sector in 2010 by sales value. The company currently has two major brands, RT Mart and Auchan. RT-Mart mainly targets the mid-and low-end market in second-or third-tier cities, Auchan is mainly designed for the high- and mid-end market in first tier cities. Auchan has 41 stores in overall China with 6 stores in Shanghai. It stocks about 1000 import product SKUs, about 15% are from the U.S. Its main clientele are young people and high income locals. Auchan has a centralized system for import distribution. Its purchasing and distribution department are located in Shanghai. RT-mart and Auchan listed in HongKong stock market in June 2011, the combined total sales volume of RT-mart and Auchan surpass Walmart and Trustmart

combined, and makes it the largest scale hypermarket operator in China. In 2011, RT-Mart opened 42 new outlets and Auchan opened 6 new outlets.

RT Mart has 185 stores in China at the end of 2010; with 14 outlets in Shanghai alone. Although overall store numbers lag behind Wal-mart and Carrefour, RT-Mart single store sales are the highest.

Wal-Mart: Currently Wal-Mart has over 370 stores nationwide, including several different operation systems: Wal-Mart supercenter, Sam's Club, Trust Mart, Smart Choice, and Neighborhood Market. Insiders informed ATO Guangzhou that more than 500 discounted compact markets, a brand new format, will soon be available in many cities. Wal-Mart is looking to further expand into the third tier and fourth tier cities in the coming years.

In 2011, Wal-Mart opened 54 new stores, including 49 supercenters, in China. These new stores are located in Guangdong's Huizhou, Longgang, and Zhaoqing; Hunan's Hengyang; and Fujian's Fuzhou, Xiamen, Nanan and Ningde. Additionally, Wal-Mart opened an e-commerce head office in Shanghai and bought a minority stake in the Chinese e-commerce company Yihaodian (Number One Store). Yihaodian boasts nearly one million registered users and sells everything from groceries to diapers to electronic products. It is also said that Wal-Mart was part of a consortium that invested in Chinese online electronic retailer "360buy."

Wal-Mart's Sam's Club membership warehouse has gained a favorable reputation by introducing more import foods to local consumers than other competitors have done. To date, five Sam's Club stores have opened in China, including one each in Shenzhen, Beijing, Shanghai, Fuzhou, and Guangzhou. The Shenzhen store is reported to be one of the most profitable Sam's Club stores in the world. Due to promising sales projections, another Sam's Club will open in Longguan, a district of Shenzhen, by 2012. However, the Dalian project, originally planned to open in 2011, was postponed. Wal-Mart now expects completion by mid 2012. In the year of 2009-2010, ATO Guangzhou, in coordination with several cooperators, worked closely with the three Sam's Club stores in South China to conduct a regional promotion featuring various U.S. snack foods and fresh items. Sales from the promotion totaled over \$ 1 million.

Despite Wal-Mart's apparent growth in 2011, the retailer did see some setbacks. A pork mislabeling pork and the resignation of several top managers somewhat downgraded the Wal-Mart image.

The Trust Mart acquisition has moved more slowly than anticipated. Taiwanese based Trust Mart used to be one of the largest retailers in China, with over 100 stores across the country, 38 of which were in South China (17 in Guangzhou, 4 in Shenzhen, 3 in Dongguan, 1 in Zhongshan, 1 in Zhanjiang, 4 in Fuzhou, 4 in Xiamen, 1 in Quanzhou, and 1 in Changsha). In 2007, Wal-Mart took the initial step to acquire a 35 percent share of Trust Mart and claimed to take further steps over the next two years to finalize the purchase. However, the acquisition was repeatedly postponed due to challenges with the merger and consolidation process. Many conflicts arose, including disagreements with an independent shopping mall land owner and concerns from local government offices regarding benefits allocation and income tax payment issues. As a result, Wal-Mart divided the nationwide Trust Mart stores into three different lots, and plans to finish consolidating the final lot in early 2012. New management has been assigned to strengthen the operation and the consolidation of Trust Mart. Once the consolidation is

complete, senior management's next challenge will be to enhance the sales performance of the newly renamed Trust Mart stores in order to catch up with the performance level seen by Wal-Mart supercenters.

French Carrefour, the World's 2nd largest retailer, now has 203 stores in China. It closed 6 under-performing stores and opened 20 new outlets in 2011. Carrefour is used to be the No.1 foreign retailer in China, but now its sales is surpassed by RT-Mart, its old operating model of charging high slotting fee towards suppliers to make money now becomes its biggest trouble. Such model is not only questioned by so many suppliers and resulted in some big suppliers like KangShiFu(the largest instant noodle brand and manufacturer in China) dropping out from Carrefour but also partly led to the new regulation jointly drafted by five China ministries and committees and made charging slotting fee illegal in China starting from Jan, 2012.

In addition, during Chinese Spring Festival period in 2011, several Carrefour stores were fined RMB500, 000 each for price tag fraud. The same price tag fraud issue was also found in Wal-Mart.

It's a tough period for Carrefour, how to regain its past glory in China market is still questionable.

Thai-Lotus Chain has 72 stores in China now. It opened 5 new outlets in 2011. This Thai-based retailer has kept trying new models and operation team in recent years. In May, 2011; it opened a new concept store in Shanghai and supposed to attract nearby white-collar workers to the store, but failed and sold out in September. In Dec, 2011, it opened another new concept store in Shanghai called "Lotus Life Station", intending to combine convenience store, coffee shop, fresh products store and hypermarket all in one, and planned to open 1000 stores in China in the near future.

AEON-Jusco

AEON-Jusco has been a well-known retailer and brand name in South China for many years. The retailer has 19 general merchandise stores in the Pearl River Delta region. These stores feature food, fashion, house wares, and electronic appliances. In the north, AEON also has presence in Qingdao and Beijing. Jusco supermarkets enjoy a good reputation in promoting import food items, mainly from Japan and Korea. ATO Guangzhou conducted several in-stores promotions, such as the "American Food Festival," with AEON-Jusco in recent years. In 2011, 19 Jusco stores launched U.S. food promotions simultaneously to promote U.S. cherries, apples, seafood, snacks, nuts, drinks, and other grocery items. It is estimated that a total of 200 plus SKUs were included. A total 40 percent of sales growth was reported after the promotion.

Last year, AEON group also introduced the new "AEON Supermarket" format both in Guangzhou and Shenzhen. With a sales floor of 32,000 square feet, the new AEON Supermarket will focus on high-end food products, accordingly the retailer created a national AEON buying team. In the near future, AEON

plans to consolidate the merchandise sourcing in both the north and south, which may encourage more import food items.

The German based, cash and carry Metro chain relies on its niche-market strategy of targeting small and medium sized restaurants, effectively positioning itself as an HRI wholesaler and distancing itself from its competitors. Metro now has 54 stores in China with 5 alone in Shanghai.

Metro has the widest selection of imported products of any of the key retailers, and 10 percent of their sales revenue is from imported products. Metro has a membership system similar to that of Sam's Club or Costco. Their large section of frozen processed foods, including desserts, frozen vegetable mixes, and frozen potato products, is easy to use and open to U.S. products. This meat case carries a large variety of both frozen and chilled beef and pork. Metro's main competition is the local wholesale market, not other high-end hypermarkets.

Its import department has upgraded to Asia sourcing center, which is responsible for not only China market but other Asian markets. At the moment, Metro has 16 stores in Vietnam, 10 in India, 10 in Pakistan, 9 in Japan and a new one in Indonesia will open soon. It's determined to import directly for all these markets and kicked out certain local distributors which makes its U.S. products range is limited. It looks for new U.S. products suppliers to import directly. For more information, please contact with ATO Shanghai.

British Tesco moved its headquarters to Shanghai in 2009 and has 21 stores in metro Shanghai. It opened a new retailing format in Shanghai in 2008. Called the "Express", which has fresh food as its core offer. Till the end of 2011, Tesco has 103 outlets in China. Import products penetration, including American products in Tesco is rather low, concentrating on a few condiment and sauces, snacks and several SKUs of wine.

China Resources Vanguard

China Resources Vanguard, as a Hong Kong operated state-owned enterprise, is one of China's leading retailers. In recent years, the retailer has been growing fast and has established a dominant market presence as the nation's top retailer both in the number of its stores and the amount of its sales. The retailer's total annual sales surpassed \$10 billion in 2010. In 2011, 400 new stores opened, bringing the nationwide total above 3, 700 outlets. CR-Vanguard's brands include Vanguard, Ole, Vango, Suguo, Better Life Together, Fun 2, Vivo, Voila wine shops, and the Pacific Coffee Company cafes.

CR-Vanguard's expansion includes both acquisition and new construction. The most recent acquisition was that of local retail chain Hong Ke Rong, which had 21 outlets, valued at \$580 million. The acquisition helped CR-Vanguard expand its distribution network in Jiangxi. Another purchase, that of Guangzhou Home City, has extended CR-Vanguard's business into many new communities.

CR-Vanguard opened its first store in Hong Kong in 1984. The retailer entered the supermarket business in Shenzhen in 1991, Suzhou in 1995, and Beijing in 1998. It acquired Suguo supermarket in 2004, then continued to purchase Tianjin's Yuetan in 2005 and Jia Shijie in 2007. In 2008, CR-Vanguard completed the acquisition of Aijia supermarket in Xi'an. Then last year, CR-Vanguard entered Wuxi by acquiring a 100 percent stake in Yongan supermarket. This Hong Kong operator manages hypermarkets, supercenters, and superstores under the Vanguard brand name. Currently in Guangdong, CR-Vanguard has over 430 hypermarkets and supermarkets.

Generally speaking, CR-Vanguard used to target customers who are more likely to buy locally produced items; however, years' of persistent marketing efforts have recently convinced CR-Vanguard that consumers are increasingly interested in high-end import foods and fresh fruits. Accordingly, the retailer has opened special import food sections in some select stores. Ole, for example, targets upper-middle income shoppers and white-collar workers. Its 7 Beijing stores are all located in business or shopping centers. There are 2 stores in Shenzhen and 1 in Guangzhou that opened last year. Import food product sales are approximately 50 percent of Ole's total food sales. The stores in Shenzhen have been successful at introducing import foods such as cheeses, chocolates, coffee, wine, liquor, biscuits, and fresh fruits. Undermining this early success is an unstable supply chain and lack of promotion to support demand growth.

Ole is reportedly planning to open stores in the east region the near future. However, many insiders observe that another new format named, "Better Life Together," which was introduced by CR-Vanguard in recent years, will probably grow faster than Ole in the near future.

Century Lianhua is the hypermarket brand of the state owned Balian group. This group's food retail side is dominated by supermarkets, but it has substantial number of hypermarkets in East China. While it is still small, they are focusing on improving their selection of imported products in both Hangzhou and Shanghai.

Department Stores

Ito Yokado and Isetan are high-end, Japanese-owned stores that target upper class consumers. These retailers' emphasis on expansion in to these second-tier markets suggests that there is easier access for high-end retailers in the second-tier markets. China wide, Ito Yokado has two stores in Beijing and one store in Chengdu. Isetan's Chinese stores are in Shanghai and the second-tier cities of Jinan, Tianjin, Chengdu, and Shenyang. Depending on the market, higher end grocery stores in a department store may carry a large selection of imported products, or a section of a store that specializes in other types of merchandise may be dedicated to imported dry goods. There are many other examples of department stores containing a high end grocery store or supermarket.

Specialty Supermarkets and Boutique Stores

Jenny Lou's is a major retailer of imported food products for expatriates, upper middle income Chinese consumers and others who have lived and studied overseas. The company established in 1995 operates 10 supermarkets in Beijing located in high-income and/or upscale communities – often near diplomatic compounds and missions. More than 90 percent of the products offered in the small supermarkets are from overseas with 50 percent from the United States. In particular, breakfast cereal, seasonings, dairy products and wine make up the greatest focus of offerings. In 2011, the Jenny Lou's was split into two companies – Jenny Lou's and Jenny's store. According to industry sources, some retail operators would like to acquire these companies to access the high end retail market given their strong consumer base, brand reputation and ideal locations.

Beijing Hua Lian High-End Supermarket (BHG) is under the Hua Lian Group targeting elite Chinese and expatriate consumers in Beijing. In the past six years, the company expanded rapidly in Beijing. Now BHG operates 15 high-end stores in town, up from 5 stores in 2010. All the stores are located in high-income areas or near diplomatic compounds, but most of the shoppers are upper middle level Chinese consumers rather than expatriates. BHG offers a wide range and selection of international products with over 40% products from United States. BHG sales data shows they sold well over \$13 and \$20 million U.S. products in 2011, with over 3,700 SKUs. Snack foods, fresh and dried fruit and nuts, and soft drinks are the most popular products in stores.

BHG has accelerated its expansion into emerging city markets and opened its first store in Huizhou, Guangzhou Province in June 2011. According to its plan, BHG will open stores in Tianjin, Yichuan, Erdos, Suzhou, Chengdu and Zhengzhou in 2012. BHG's expansion is bringing branded products marketing to these emerging markets as well as developing distribution networks for imported food.

City Shop sells an extensive range of imported foods. Over 85% of City Shop's products are imported. City Shop carries nearly 3,000 American food and non-food products, which make up 1/3 of total product SKUs, while contributing 50% of overall sales. Started as a corner shop by a former Cochran fellow, City Shop now has 9 retail outlets in Shanghai and two in Beijing. It has developed its own system of retail and wholesale services. It maintains its own farms with internationally recognized organic farming and logistics systems. It produces 140 different organic vegetables and herbs, and produce is transported daily via temperature-controlled trucks to City Shop outlets and other wholesale business partners.

Ole: operated by CRV, targets upper-middle income shoppers and white-collar workers. Its 10 Beijing stores are all located in business or shopping centers. There are two stores in Shenzhen, one in Dongguan with another set to open in Guangzhou. In eastern China, it has 5 stores with 4 in Shanghai and one each in Hangzhou and Ningbo. Imported food product sales are approximately 50 percent or more of total food sales. The stores in Shenzhen have been successful in introducing imported foods such as cheeses, chocolates, coffee, wine, liquor, biscuits, and fresh fruits at higher prices. One of its stores in Shanghai successfully attracted locals to shop there even with higher price for both imports and domestic products.

Supermarkets

Lianhua, Hualian and Nonggongshang are three large state owned supermarket chains. These, and other domestic firms, dominate the supermarket sector. Although Lianhua and Hualian were nominally merged three years ago to form the behemoth Bailian, the second largest retailer group in China, they continue to operate as distinct (and competitive) chains. Bailian appears to be more focused on rationalizing its diverse portfolio, and developing its shopping mall management component. Both Lianhua and Hualian have expanded aggressively through acquisitions of other chains, leaving both companies with the challenge of incorporating them into already weak state owned management structures. Inspired by foreign-invested companies, the Chinese chains are paying greater attention to branding, and most now carry a substantial number of house brands.

All three have also opened branded hypermarkets in and beyond Shanghai, and Lianhua is putting a particularly strong effort into its Century Lianhua hypermarkets. Although Nonggongshang's market share has slipped, it is attempting to expand its reach to match Lianhua and Hualian, opening NGS hypermarkets in distant cities like Nanchang, with mixed results.

The state owned supermarket chains also play another role in the past – that of the local partner of international retailers. The international players had to agree to this to enter China. So Lianhua, for example, owns a large minority position in both Carrefour and Metro.

China Resources Vanguard also has a large number of supermarkets. It acquired with Suguo, a regional giant headquartered in Nanjing in 2004. The brands continue to operate independently.

Wu-Mart is a major retail chain based in Beijing operating 2,578 stores throughout China including hypermarkets, supermarkets, and convenience stores targeting middle class and lower end consumers. The outlets are mainly located in Beijing, Tianjin and Zhejiang and Ningxia Provinces. According to company financial reports total revenue was up some 14.9% reaching more than \$5 billion in 2011. Competition is fierce in the retail industry in Beijing with price competition in particular key to long term profitability. Retailers try to attract upper mid-level consumers and offer imported products to achieve higher profit margins. Wu-Mart is planning to open its first high end store in Beijing to join the increasing wave of imported product competition.

Advantages and Challenges for U.S. Products

Overall, U.S. products enjoy a high image in the China market. Rising incomes and growing concerns over food safety among Chinese consumers after numerous episodes of food contamination mean there will be more opportunities for U.S. products, which are largely perceived as safe and wholesome. On the other hand, price is still one of the barriers for U.S. products to reach more Chinese consumers; other challenges include labeling regulations, distribution, and limited product knowledge. The following table provides further details:

Advantages and Challenges for *U.S. Products*

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

Competition and Best Prospects

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

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

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

Third country competition comes in two distinct areas: commodity-type products such as frozen meat, poultry, seafood and fresh fruit, and western-style niche products such as canned and prepared foods and ethnic cuisines and ingredients. Competition in the fresh and frozen meat, fruit and vegetables arena, as well as dairy, comes primarily from Pacific rim neighbors, including Thailand, New Zealand, Australia, Canada and Chile, as well as South Africa and Brazil. Competition for western-style prepared foods is much more global, with competitors playing to their strengths in individual products such as olive oil, wine, pasta and pasta sauces.

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

Key Products and Competitors

Selected U.S. Imported Products	Main Foreign Competitors
Red Meat	Canada, Denmark, New Zealand, Australia

Poultry: chicken paws & wing tips	Brazil, Argentina
Oranges	New Zealand, South Africa
California Table Grapes	Chile
Washington Apples	Chile, New Zealand
Cherries	New Zealand
Breakfast Cereal	United Kingdom, Australia, EU
Cheese and Dairy	New Zealand, Australia, EU
Frozen Processed Products	Canada, New Zealand
Wine	Australia, France, Italy, Spain, Chile
Spaghetti sauce/tomato products	Italy, France, EU
Coffee	Japan, France, South Africa
Candy and Chocolate	Switzerland, Italy, France, Belgium, Japan
Nuts	Iran (pistachios), Mongolia, Korea (chestnuts) Russia
Seafood	Russia, North Korea, Canada, Norway, Japan
Ginseng	Canada, Korea
Dried fruit: prunes and raisins	France and Italy (prunes)
Baby food/infant formula	New Zealand, Switzerland
Premium Ice Cream	France, New Zealand

Best Products Prospects

Products Present in the Market Which Have Good Sales Potential

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

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

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

- Functional foods

Guidelines for Entering the Market

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

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

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

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

range of concerns related to China's new Food Safety Law. Please see the FAS FAIRS reports for China on the FAS website for details (www.FAS.USDA.gov; attaché reports) or the website for China's Administration for Quality Standards, Inspection and Quarantine (AQSIQ) at www.AQSIQ.gov.cn.

4) Get to know the market. As noted above, China is a surprisingly diverse place. Tastes, customs, culture, business practices and government regulations vary from place to place. Experience in other markets will not necessarily help in China, and some aspects of the market need to be witnessed to be fully understood. The best strategy is to target a specific place and get to know it well. The scope of your effort will determine whether you select a single city or a whole region. Travel to China is highly recommended to evaluate partnerships, build *guanxi* (see above), and identify new opportunities and potential obstacles. (Partners are frequently hesitant to mention problems in formal communications, but will be more forthcoming over informal events like dinners). FAS market briefs offer a good source of information on the market, and are available for free on the FAS website noted above. One way of getting to know the market is to visit the two international food shows in China which are endorsed by USDA. These include The FHC and SIAL show. ATO Shanghai hosts USA pavilions at these shows which will be attended by most professionals from China's food sector.

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

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

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

important part of any gift. Many exporters seeking to break into the gift market have special packages manufactured in China, which can also help to address labeling issues.

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

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

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

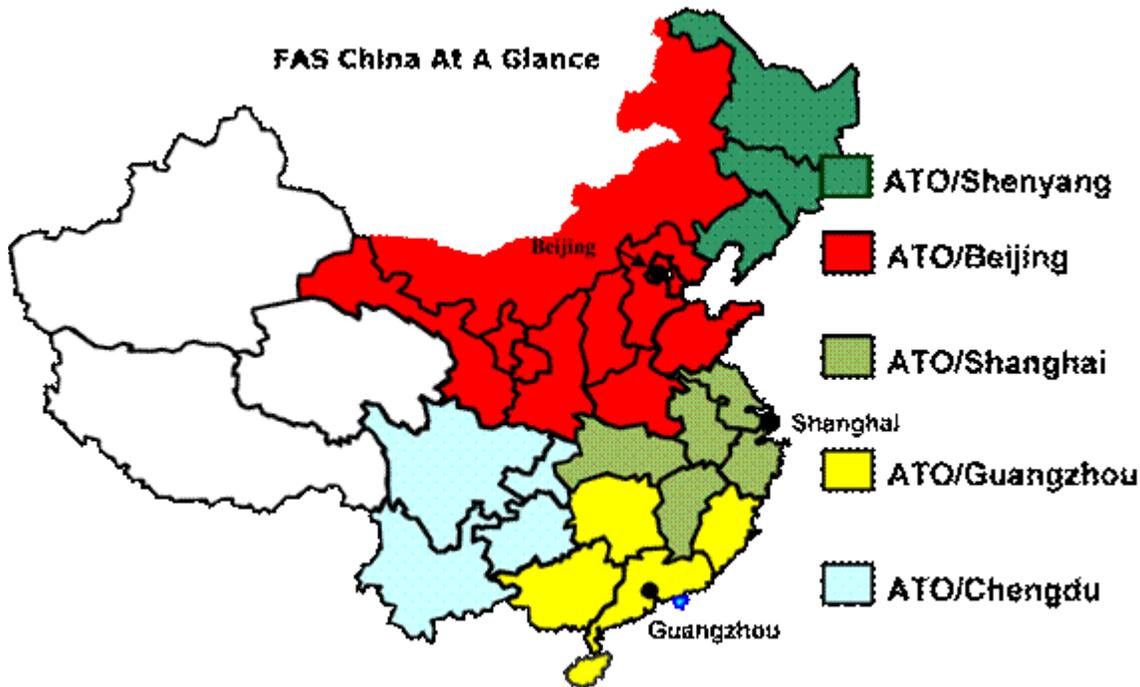
www.wusata.org

www.feusa.org

Regional Profiles

China is a diverse place, and fragmented distribution and logistics systems help to reinforce existing divisions. To assist exporters in dealing with these regional differences, FAS maintains six offices in

China, with Agricultural Trade Offices (ATO) in Beijing, Shanghai, Guangzhou, Chengdu and Shenyang , and an Agricultural Affairs Office(AAO) in Beijing. The ATOs are those to help U.S companies enter the market and to support local importers/distributors of U.S. products. The AAO in Beijing is responsible for trade policy and market access issues. Individual market profiles for each region are offered in the following sections, written by the respective ATO offices.



Eastern China - Shanghai and Yangtze River Delta

The city of Shanghai is a massive market unto itself, with a population estimated at more than 20 million, and incomes among the highest anywhere in China. As costs in the city have risen, the economy has begun to shift away from manufacturing and into financial and management services. Manufacturers seeking to escape high costs in the city while taking advantage of the infrastructure and massive consumer base have created an economic boom in the surrounding region. The city is located at the center of a web of economic development that includes the provinces of Zhejiang and Jiangsu, and is collectively referred to as the Yangtze River Delta (YRD). This region accounts for nearly 1/3 of mainland China’s GDP. Massive infrastructure investment has led to major improvements in logistics and drawn the region closer together. With the upgraded high-speed rail network in the YRD, the travel time is reduced to 30 minutes to Hangzhou, the capital of Zhejiang province and 1 hour to Nanjing, the capital of Jiangsu province. The opening of the Yangshan deepwater port facility is expected to make Shanghai the world’s largest container port within the next few years. Shanghai’s large expatriate

community (estimated at 500,000) is dominated by Taiwanese, who bring with them a familiarity with foreign brands and a taste for U.S. and Japanese foods. Taiwan companies dominate the baking sector and also hold more than 50% of the dry noodle market in China.

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

Benefit from the healthy development of economy in China and increasing household incomes, retailing in Shanghai sees more upward trend to cater to the upgrading consumption structure of local consumers. More high-end retail shops opened in Shanghai in 2011 not only from State-owned enterprise but also from private company or individual investors. Ole, a high-end retail format of China Resources Vanguard, opened its first store in Shanghai at the end of July, 2010. Now Ole has four stores in Shanghai and one store in Ningbo and with another one in Hangzhou. Imported products make up more than 70 pct of their total SKUs. Hong Kong based City Super opened its first store in May, 2010. And Taste, another Hong Kong based high-end retailer, also opened its store in Shanghai. In addition, some food importers opened their own retail stores as well; and investors, who used to be in real estate or hotel or export business, expanded their business portfolio to import food business and opened their own stores in Shanghai. These quickly popping up new import products stores demonstrated that consumers in Shanghai are trading up to buy more better quality grocery products for their daily meals.

Another contributing factor to the prosperous import food products stores opening is the continuous food scandals in China. This year, following products are disclosed by the media with quality problem; hot pot seasoning, rice, frozen dumplings and egg. Although melamine scandal in milk powder is in the past, consumers still doubted the supervision capability of local authority. And in fact few cases happened in other provinces revealed by the media disclosed that some enterprises are still using melamine in their milk products. Thus consumers in Shanghai generally prefer to buy import milk or milk powder for their child if they can afford.

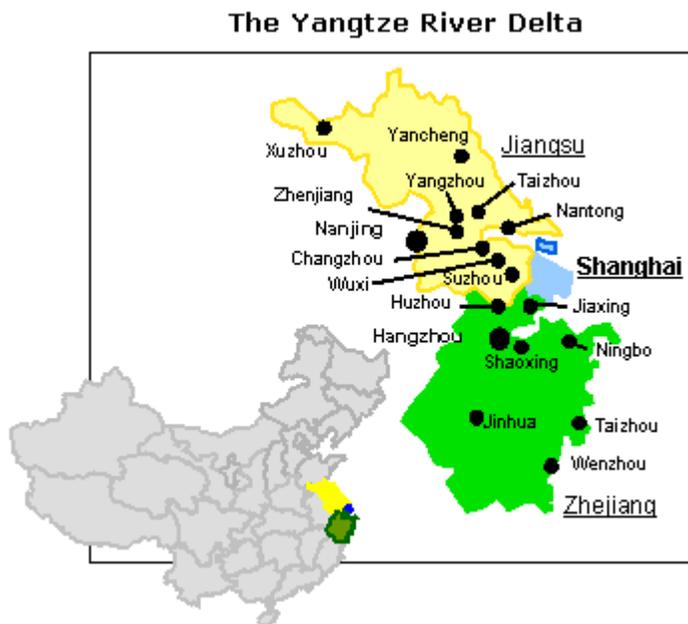
With the above said, there are still rooms in Shanghai for high-end import products stores especially in high-end communities. While product assortment and service will be the key for these high-end retail formats to be successful in Shanghai and YRD markets.

Convenience store is another booming sector in Shanghai market. 7-11 partnered with Taiwan based Uni-President has more than 100 stores in Shanghai at the moment. Next year they will open their franchises rights to the public and it's expected they will have 300 stores in Shanghai by 2014. Another

fast expanding player is Family mart, partnered with another Taiwan based food enterprise Ting Hisin International Group, Family mart now has about 600 stores in Shanghai and is planning to open more in Shanghai and China. International grocery retailers were setting their sights on opening convenience stores in Shanghai too, Tesco introduced its Tesco Express brand in Shanghai and Walmart is planning to open its Smart Choice outlet in the near future.

Beyond Shanghai

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



The capital of Zhejiang Province, **Hangzhou** hosts Carrefour, Metro, Lotus, Auchan, Wal-Mart, Lianhua, and Hymall, among other super- and hypermarkets. Hangzhou's retail market is doing far better than expectations: in an ATO-organized nationwide retail promotion involving 24 Carrefour stores, the Hangzhou store ranked 7th in sales: ahead of Guangzhou and following stores only in Shanghai (4 stores) and Beijing (2 stores). In addition, the Hangzhou store was extremely aggressive in recruiting distributors and products for the event, and ultimately carried far more items than originally agreed. (Please see [CH7819](#)). In a departure for a state owned chain, Lianhua is actively promoting imported products in Hangzhou and opened a specialty supermarket concentrating on imported products.

Suzhou's market is steadily growing, and a privately-owned cold chain already exists, with temperature-controlled warehouses and delivery trucks. Metro has established itself in Suzhou as the destination for one-stop shopping, and its membership is already 130,000 strong. To further stimulate market growth, the city's infrastructure is developing at light speed. Several new highways were built recently; bridges cross the Yangtze River. (Please see [CH7816](#)). With the high-speed rail in use, Suzhou now is just within an hour distance from Shanghai, some community based high-end gourmet stores opened in Suzhou catering to expatriates and Chinese consumers' needs. ATO Shanghai conducted an in-store promotion with Suzhou based Enjoy-city supermarket chain at nine of its outlets in 2011. Almost 600 new SKUs were introduced for the first time to consumers in Suzhou. For details, please see the recent report [CH12803](#).

Development is now moving on to a third tier of cities. Particularly notable are **Wuxi**, which has become a major distribution center for seafood and meat products in the YRD area (see the recent report [CH8806](#) for more information); **Ningbo**, which has average incomes on par with Shanghai but a less well-developed retail sector; and **Nanjing**, the capital of Jiangsu province.

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

Although **Wenzhou** is one of the richest cities in China, its market for foreign imports is still relatively underdeveloped. Wenzhou was only opened to international retail giants in 2006. While the market was slow to open, the retail sector is growing quickly. According to the Wenzhou Retail Association, a "Sourcing Alliance" consisting of all the important retailers in Wenzhou was organized in 2008 to consolidate the sourcing of imported food products, to strengthen the bargaining power of Wenzhou retailers against food importers. (Please see [CH7814](#)).

Wuhan, in Hubei province offers a mid-range prospect. It has a reasonably well-developed retail sector, with Metro, Carrefour and Wal-Mart all represented. As income levels rise throughout urban areas in China, potential markets are emerging in growing cities everywhere. In 2007 08, and 09 ATO Shanghai conducted multilevel campaigns to promote U.S. food products in Wuhan. These events have exceeded our expectations, and we have succeeded in introducing several hundred SKUs to consumers in Wuhan. The city seems receptive to American products, and with the rapid increase of supermarkets, hypermarkets and convenience stores, as well as more than 40,000 restaurants, it has a reasonably developed retail sector. (Please see [CH7815](#), and [CH9801](#).)

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

Beijing and North China

The northern China retail industry continued to boom in 2011 against the backdrop of high food price inflation, and increasing labor and rent costs. The retail market in Beijing is near saturation and it is very hard to find locations for new outlets as retailers look for new opportunities and profits in the high end market by offering a variety of imported food products to bolster their image and lure more upper middle level consumers. Due to the competition in Beijing, more and more retailers are moving their focus to second tier emerging cities, especially in Tianjin, Qingdao and Xi'an. Compared with the majority of domestic retail players, multinational retail players are rapidly adding new stores. In addition, logistics capabilities have become the core competitiveness factor for many retailers. Due to the expanding service regions and increasing number of outlets, it is very important for retailers to set up central distribution to improve operational efficiency and sustain product inventories. Also, direct purchasing is another trend in the industry, which is squeezing out distributors and middle men further while providing higher profit margins for retailers and competitive product prices to consumers. According to major retail players' forecasts, the value of direct purchases will increase by about 10% in 2012.

Beijing consumers are changing where they shop for food with demand shifting rapidly away from "wet" or open air markets to supermarkets and convenience stores. Retail consumer sales totaled more than \$82.97 billion in 2010 or up 17.3% over 2009. Competition is extremely intense in Beijing as more stores with higher standards are built and local consumers demand more diversity and higher quality food at competitive prices. Purchase price is no longer the top determining factor for customers.

Key international hypermarket operators in China have all set up their outlets in Beijing, including Carrefour, Wal-Mart, Tesco, Jusco, Ito-Yokado, RT-Mart and Metro. Competition in the retail industry is shifting from price to product offerings. Most retail players are sourcing high quality products, especially imported food products to widen their selection and lure more upper middle level consumers. Even hypermarkets in town have set up special aisles to offer imported food products. The high end supermarket format is booming in the city, led by BHG. BHG stores feature wide aisles and relaxed atmosphere, modeled on Whole Foods stores, which is proving a compelling alternative to the crowded and noisy environment of more standard, mid-range stores. 7-11 is leading the convenience store format in Beijing operating 106 stores. In 2012 the 7-11 group will develop franchise stores to accelerate its expansion in Beijing. Imported food products from Europe and the U. S. are very popular in the market given their high quality and reputation. In contrast, products from Southeast Asia and Korea only take a small percentage in the high end market.

Customers in **Qingdao** have shifted from wet markets to supermarkets because of a booming economy and higher per capita incomes. The competition in Qingdao's retail sector includes Jusco, Carrefour, Wal-Mart, Metro, Maykel, Parkson, RT-Mart, Tesco, Hisense Plaza and Liqun Group. Hua Run will open its first store in Qingdao in 2012. ATO Beijing has noticed major retailers in China are paying more attention to coastal ECM cities in North China. Most retailers have outlets located downtown and the local and multinational retailer competition is only expected to intensify as Qingdao-based Liqun Group and Hisense expand and defend their market share. Hisense Supermarket partnered with ATO Beijing in holding a U.S. Food Promotion in 2009, 2010 and 2011. The store now offers over 1,200 SKUs of U.S. products ranging from seafood to fresh fruit, dairy products to snack food, and frozen products to wine. The sales for the 2 week promotion in 2011 reached over \$100,000. Other efforts undertaken by ATO Beijing were promotions in Qingdao and Shandong Province such as the American Food Festival with Jusco in its 5 outlets in Shandong in July 2010 (3 in Qingdao and 1 each in Weihai and Yantai) featuring more than 300 SKU's of American Food Products.

Tianjin's per capita GDP is much lower than Beijing and Shanghai, and consumers are more conservative in their habits. As a result more customers shop in wet markets since they are price sensitive. Imported products are available in limited supply in some upscale retail outlets located downtown such as E-Mart and CRV. In addition, most imported products on the shelves are from Southeast Asia, Korea and Japan. Korean chain E-Mart entered into a joint venture with the TEDA (Tianjin Economic Development Area) and has five supermarkets targeting upper middle class customers and Korean expatriates. CRV has become the city's top local retail operator in terms of sales after taking over its rival Home World. The acquisition also gave CRV a significant market share in the city. Now the company runs 20 hypermarkets and over one hundred supermarkets in Tianjin.

Outside the city center, by far the best market for imports is in the Binhai New Area, because of the large number of white-collar workers employed by multinational companies and expatriates living there. Tesco stores located in the Binhai New Area offer a wide selection of imported food products. In addition, Jusco opened its first hypermarket in Tianjin in September 2010. However, supplies of imported foods are significantly constrained by poor distribution, especially for U.S. products. Distributors in town have limited contact information about U.S. food importers and have trouble getting them interested in the local market because of the presence of the richer nearby Beijing market. However, with increasing incomes, consumers are more interested in high quality food products from the United States and Europe. And, emerging markets have gotten the attention of high end supermarket players; Ole under CRV and BHG. Ole will open its first store in Tianjin in 2012 and according to BHG's strategy they will open 3 stores in Tianjin in 2012. ATO Beijing expects that with the active participation of BHG and Ole, distribution channels in Tianjin will be improve gradually over time.

Zhengzhou – Based on geographical location and its advantage as a major rail hub and large population the retail base has developed rapidly in this major inland urban center. Customers enjoy shopping in hypermarkets and supermarkets for high quality and safe products. Multinational retailers such as Carrefour, Wal-Mart, Metro and RT-Mart have all established outlets in the city. Domestic retailer – Hua Run (Vanguard) has been expanding in the city and the Province since they set up their Northwest headquarters in Xi'an. In addition, the regional retailer, Dennis, attracts high customer traffic as well being the first to launch in the market. Competing with Carrefour and Wal-Mart, Hua Run and Dennis are more popular and active in the city. The majority of imported food products carried by retailers are from Korea and Southeast Asia. Group purchasing is the primary channel to sell imported food products.

Zhengzhou is also a distribution center for imported foods to inland third tier cities in the surrounding provinces given its convenient and available transportation links.

The retail business in **Hebei Province** has developed quickly despite near complete dominance by local Chinese retail companies. In the Provincial Capital, Shijiazhuang, the mature and well-managed local retail outlets have prime locations and consumer loyalty. This has made Shijiazhuang a challenging market area for international retailers. In 2010, Carrefour launched its efforts in cooperation with a local retailer operating 7 stores. In addition, Wal-Mart will open its first store in Shijiazhuang in 2012. The booming retail business is characterized by many upscale retail outlets with special imported food sections or shelves. It's easy to source American and European food products in town. Imported food products can also be sourced in third tier cities such as Tangshan and Qinhuangdao although products are typically limited to cookies and snack foods originating from Korea and SE-East Asia. Outside Shijiazhuang international retailers have made some inroads such as Taiwan-based RT-Mart which operates the most popular retail outlet in Tangshan. Carrefour opened its first store in Tangshan in 2010 and Tesco launched its first life space shopping mall in Qinhuangdao in Jan. 2010.

Xi'an, the capital of Shaanxi Province is considered the gateway to northwestern China. Over the last 4-5 years the retail sector has developed rapidly. China Resources Vanguard (CRV) dominates the retail market with 23 stores in Xi'an and 34 stores in Shanxi Province. In addition, CRV's northwest regional office is located in Xi'an covering 5 provinces in Northwest China – Shanxi, Ningxia, Gansu, Henan and Qinghai as well as operating 36 supermarkets in the region. CRV is eager to lure more upper middle class consumers by offering a wider variety of imported food products. Wal-Mart operates 6 hypermarkets in Xi'an. Metro is the top destination for HRI operators and upper middle level consumers to source wine, meat, flavorings and cooking equipment. Metro's Xi'an store is in the top 5 Metro stores in China in terms of sales. Customers in Xi'an have limited knowledge about U.S. products and are normally are very sensitive to price. Despite this, demand for U.S. products has increased rapidly year by year and according to the purchasing manager of CRV, sales of imported food products increased 60% in 2011 over 2010. Major retail players in China smell the ripe market opportunities and are scrambling to open high end brand stores in Xi'an. Sam's Club under Wal-Mart and Ole under CRV will open their first stores in Xi'an in 2012. In addition, Metro will open its second store in Xi'an in 2012 based on their exceptional sales results. However, logistics are still a barrier for expanding the market, although the situation is improving gradually given more regional distribution centers established by key retail operators. Based on these distribution improvements and direct relationships with importers, imported food products can be distributed further inland to second and third emerging market cities in Northwest China.

South China Regional Profile

SUMMARY: In 2011, aggressive retail outlet expansion plans by the leading chains penetrated into new South China markets: satellite cities around Shenzhen and Guangzhou, as well as second and third tiers cities outside Guangdong. In order to increase in-store traffic and per ticket sale expenditures, retailers placed greater emphasis on in-store promotions and made significant improvements to merchandising assortment management. E-commerce and online shopping put the retail chain's brand loyalty with consumers to the test. In many of the leading retail chain outlets, new merchandising development programs are underway to introduce natural and organic food products. Leading retailers, both

multinational and domestic players, are consolidating and applying strategic acquisition plans to gain greater market share in urban enclaves in 2nd and 3rd tier cities in South China and in particular in the Pearl River Delta, where minimum and medium wages are the highest in China.

Regional Economic Outlook

Although China's brisk-paced economic growth slowed down in 2011, a recent news report revealed that Guangdong province reached a record high gross domestic product (GDP) of \$793 billion, a 10-percent increase from the previous year, leaving far behind the second highest GDP growth of Jiangsu in east China with \$634 billion. Guangdong had the highest GDP of any province in China for the previous three years with the 2010 total retail sales of consumer goods reaching \$236.4 billion. Fujian province's GDP in 2010 was up 15 percent from the previous year and its total retail sales of consumer goods was 16 percent higher. Hunan, Guangxi and Hainan provinces also saw continuous GDP growth.

By the end of 2010, five provinces (Guangdong, Fujian, Guangxi, Hunan, and Hainan) in South China had a total official population of 261 million, which accounts for almost one fifth of China's total population. On average, food consumption accounts for over 36 percent of Southern consumers' total expenditure. For the fifth consecutive year, Guangdong ranked first in per capita annual food consumption expenditures. Accordingly, South China continues to be a dynamic processed-food-consumption market with abundant growth potential.

Developments in the Retail Food Market

Inflation

The inflation of food prices in China has significantly reduced the price difference between import and domestic food items. However, soaring retail prices have also made consumers more cautious when making purchases.

Decline of Japanese products

The earthquake in Japan caused a sharp drop in sales of Japanese food items in China. Retailers quickly replaced Japanese items with more choices from suppliers in Europe, Australia, New Zealand and the United States.

Food safety

Media reports mentioned a pork food safety scandal and several mislabeling cases, one of which led to a later closure of a Wal-Mart retail outlet. Milk quality remains suspect as a Mengniu (a leading Chinese milk producer) recall aroused attention about China's ability to deal with food safety issues. In general, consumers in the South pay close attention to food safety and nutrition issues. They are willing to pay a premium price for quality, safe products.

Closing the retail gender gap

While women have been a major target consumer group for retailers, retail chain marketing teams report increasing numbers of male shoppers. Men are increasing their average purchasing times, purchase limits, product categories, and frequency in supermarkets in the past year. More men claimed that they also made purchases from television or online advertisements. These trends are closing the gap between male and female retail food shoppers.

Demand for packaged products

The increasing number of single households has encouraged more retailers to offer small packages and ready-to-serve products. Chinese holiday celebrations and group purchases continue to be seasonal highlights. Gift-packaged products helped increase sales for items such as chocolates, nuts, cookies and even fresh fruit, which was displayed in gift packages on retail shelves. Private labels with special package designs are also popular marketing practices.

A taste for import food

The middle class, with a higher per capita disposable income, is open to new tastes and varieties. Well-off consumers in coastal cities are seeking for more natural and healthy products. What's more, additional investment is flowing into import businesses as the global economic slowdown has hindered the re-export market mainly based in South China. All these developments have had a positive impact on the consumption of import food items entering into South China.

New products

With the retail sector's rapid development and continuous GDP growth, South China continues to play an important role in marketing import packaged food items such as almonds, pistachios, pecans, walnuts, candies, juices, wine, dairy, and condiments. Fresh, imported, deciduous fruits such as apples and table grapes from overseas suppliers are enjoying favorable sales. U.S. cherries and citrus have also gained ground in recent years.

Retailer's Profile in South China

Supermarkets and hypermarkets are the most common formats for food retail; however, diverse, new formats are emerging and shifting the trend. The convenience store format is the most vibrant new sub-sector—with chain store networks focusing on expanding into large urban centers and extending their reach into provincial towns and rural villages. Because most individually-owned convenience stores are running on very low margins, large chains are beginning to aggressively target weaker competitors with lower efficiencies or poor financial conditions, aiming to take the smaller players out of the market.

Chain convenience stores

7-Eleven still takes the lead in the South with over 600 outlets concentrated mostly in Guangzhou, Shenzhen and neighboring cities such as Dongguan and Zhuhai. In order to gain more market share, 7-Eleven opened the door to franchising recently. This chain's growth is expected to jump off with some investment banks contributing to the financing of inland outlets. 7-Eleven will also launch a new online business platform that will cater to group purchases and individual sales.

Watson's is also expanding rapidly with over 300 outlets nationwide offering select import food items. Taiwan-based *XiShiduo (C-Store)* has over 150 convenience stores in the Guangzhou and Shenzhen areas, mostly located in affluent urban enclaves. Other convenient store brands include *Family Mart*, *OK*, *Jiadeshi*, and *BP* gas stations.

With ATO Guangzhou's continuous marketing efforts, new U.S. import food distribution channels have emerged through the small chain convenience store format. For example, *Mannings*, a convenience store oriented around the sale of lifestyle products and health and beauty skin care products, started marketing U.S. import snacks. In partnership with a key South China distributor, ATO Guangzhou worked with *Mannings* to conduct on-the-spot demonstrations and tastings for over 20 pre-selected SKUs. This promotion lasted for three weeks and brought in \$140,000 USD, which was three times the expected result. The promotion created an opening for U.S. producer associations and exporters to enter into an entirely new sales channel previously viewed as impenetrable.

Import food stores

Corner's Deli is one of the fastest growing specialized import food stores. It has over 11 outlets in Guangdong and Hainan, all featuring a wide range of import food items.

Other import food stores that opened in Guangzhou or Shenzhen are found within or near inner city high-end apartment complexes. These include, *Storex*, *D.D. Store*, *Feast (Frozen Meat & Seafood)*, *Fresh*, *Italian Corner*, *Oliver*, and *Sharefoods*. Independent import wine shops are also springing up.

Specialized fresh fruit stores

Pagoda has over 200 fruit stores in Guangdong. The head office of Pagoda is in Shenzhen. In 2010, the first Pagoda Haikou outlet was opened, and sales surpassed expectation by 20 percent. Two more stores opened in 2011. Another 20 new stores are reported to open in the coming years.

Large retail groups

Multinational retail groups in South China include *Wal-Mart* (66 supercenters, up by 8 since 2010), *Carrefour* (32, up by 3), *Jusco* (19 GMS, up by 3), *Metro* (12, up by 2), and *Tesco* (12, up by 4).

Regional retail players in South China include *Parkn'shop*, *Renrenle*, *Trust-Mart*, and *Rainbow* in Guangdong; *Nancheng Department Store* and *Nikko Nikodo* in Guangxi; and *Bubugao (Better Life)* in Hunan. Taiwan's *R-T Mart* also has stores in second-tier cities.

In recent years, leading domestic retailer *China Resources Vanguard* has also made great progress in obtaining market share by purchasing other local brands and opening new stores (400 new stores were opened nationwide in 2011).

Large retail groups have also begun experimenting with smaller supermarket formats. *Park n' Shop* introduced *Taste*, a high-end supermarket. Subsequently, Japanese retailer *AEON Group* introduced *AEON*, a smaller supermarket also featuring high-end products. Wal-Mart has started opening new formats such as *Smart Choice*, a discounted compact store. CR-Vanguard has also explored various retail formats including *Vango*, a 24-hour convenience store; *Voila*, a wine cellar outlet; and *Better Life*, a small community market.

The region's ever-growing retail performance also attracts expats to open businesses in South China. A Chinese-American opened a *Safe Max* supermarket in the center of Guangzhou's new Pearl River New City, offering diverse food items imported from the United States.

Many of these multinational retailers have begun including a natural/healthy section in their supermarkets and hypermarkets to meet increasing consumer demand for these products and to upgrade their image. On occasion, these retailers will also launch "in-store food festivals" and other promotions to attract more traffic. While regional retailers are aware of the increasing demand for import food items, Jusco, Ole, Metro, and Sam's Club remain the best venues for U.S. import product sales. ATO Guangzhou has been working closely with China Resources Vanguard, as well as its key suppliers, to promote U.S. products. The retailer has introduced many import food items, especially in its Ole stores.

Traditional department stores, such as *Guangdong Friendship Store* and *Guang Bai Department Store*, began to renovate and expand their food selling floors. The retailers created specialized import sections to meet the increasing demand for high-end food items.

Emerging City Markets

South China's key consumption markets for U.S. import foods are Guangzhou and Shenzhen. Many retailers have already opened stores in satellite cities around Shenzhen, such as Longgang and the Nanshan district.

Guangdong's emerging markets are in cities such as Dongguan, Foshan, Zhuhai, Jiangmen, Zhongshan, Huiyang, Zhanjiang, and Shantou. In Fujian and Hunan provinces, Fuzhou, Xiamen, and Changsha are also seen as attractive locations for retailers. Nanning, Guilin and Liuzhou in Guangxi are also recognized as high potential markets. In addition, Hainan reported the construction of major retail development projects.

Dongguan

Dongguan is a key manufacturing base in South China. In the past 20 years, Dongguan has held a steady annual growth rate of 20 percent and is known as China's economic powerhouse of foreign investment. The city has gained a large number of expats and well-to-do residents. Sitting between Guangzhou and Shenzhen, Dongguan is 56 miles north of Shenzhen, 31 miles south of Guangzhou, 47

miles from Hong Kong, and 48 miles from Macau. Its transportation systems connect to five ports, Shenzhen-Guangzhou railways, and inter-town freeways. The city occupies 952 square miles with a population of 1.7 million locals and 5.24 million migrant workers from all regions of China. Both multinational and domestic retailers are jockeying to capture the best commercial sites and obtain or expand their market share in the city. Currently, the city has four Wal-Mart stores, three Trust-Mart stores, three Carrefour stores, four Tesco stores, one Metro, and one Jusco, as well as eight CR-Vanguard stores. More new stores are scheduled to open.

Zhuhai

Zhuhai is touted as a romantic coastal city in the western band of the Pearl River Delta. It boasts over 94 hotels and is ranked third in the region's tourism development after Guangzhou and Shenzhen. In recent years, Zhuhai has made progress in economic development due to its advantageous geographical location to Hong Kong and Macau. Zhuhai retail is currently booming.

At present, Zhuhai has one Jusco and four CR-Vanguard stores. Import food consumption is increasing. Wine shops and specially designated import food stores attract expats, local consumers, and Macau residents. Substantial investments in transportation projects are expected to help further facilitate trade. Upon the completion of the 18-mile Hong Kong-Zhuhai-Macau Bridge, Zhuhai will become a more critical logistics hub for Hong Kong, Macau, Western Pearl River Delta (Zhongshan, Jiangmen, and Zhanjiang) and Southwest China (namely, Guangxi province).

Jiangmen

Jiangmen is hometown to many overseas Chinese. Accordingly, many households there have some exposure to Western lifestyle and U.S. food culture. Previously, local consumers might have tasted high quality U.S. food items through their relatives once a year, however, now, with Jiangmen Yihua supermarket, hundreds of top-brand overseas health food products are available in their own neighborhood. In 2010, Yihua Department Store launched the Christmas-themed opening ceremony and a press roundtable for the American Food Festival in Jiangmen, featuring over 300 SKUs of U.S. food and beverages. The promotion received positive feedback from media and mass consumers.

Changsha

Changsha is a dynamic consumption market with the presence of both multinational retailers and many established local players. Changsha has a population of 7.1 million, among which 4.5 million are urban residents. Changsha accounts for one fourth of the total GDP in Hunan province. An expressway has linked Changsha with Zhuzhou, Xiangtan, and the Chang-Zhu-Xiang business circle, which are all now within a one-hour commute of each other. With the completion of the Wuhan-Guangzhou express railway, Guangzhou is now within two hours' travel time of Changsha, a city that has long been recognized as a key mid-south market.

Metro and Carrefour first entered this market in 2001, followed by Wal-Mart in 2003. Over the past nine years, competition has been increasingly fierce. There are now three Wal-Mart stores, three Carrefour stores, three RT-Mart stores, one Metro store, one Trust Mart store, one Japanese Hemito (Ping He

Tang) store, and one Lotus store. In addition, there are several local players: five Xinyijia stores, six Jiarunduo, and four Hyper Market stores (a local retailer previously known as Better Life).

Locals prefer hot spicy, sour, and heavy flavors. However, increasing consumer awareness of healthy lifestyles is fueling a growing demand for high-quality import food items. The most popular of such items includes biscuits and chocolates (from Germany, Britain, Italy, Japan and Korea), olive oil (from Spain), wine (from France, Chile, Australia and the States), fresh fruits (from the United States, Canada, Australia and New Zealand, as well as Southeast Asia countries such as Thailand and Vietnam), cheese (from France and the United States), one liter packaged milk (from New Zealand and Australia), as well as seasoning and condiments (from the United States, Korea, Japan, Germany and Italy). Popular U.S. brands include Hunt's, Heinz, Swiss Miss, Del Monte, Planter's, Land O' Lake's, and Starbucks coffee.

Local consumers prefer fresh food items. There is a tendency for retailers to pay greater attention to cold chain management and freshness maintenance in the Changsha retail market. Carrefour and Better Life Hypermarket as well as RT-Mart all have set up in-store coolers for displaying frozen food items. Better Life Hypermarket even set up a special refrigerated fruit display area to maintain freshness. Most retailers have an imported fresh fruit display area in their stores. Out of all of the foreign retail chains visited in Changsha, Wal-Mart was the least competitive mainly because they only carry low-priced domestic products. Wal-Mart Changsha's store design is antiquated with poor lighting, displays or helpful staff.

Fuzhou

Fuzhou, the capital city of Fujian province, is the hometown for many Chinese living abroad. This gateway to Taiwan has attracted substantial investment and plays an important role in cross-strait trade. As an important port city, it recently had ambitious expansion plans for infrastructure and logistic development. An estimated 80 percent of Taiwanese are Fujian decedents. Fuzhou is one of the key markets for import foods as many residents have relatives living abroad and are more open to Western lifestyles. Existing key retailers in Fuzhou include three Wal-Mart stores, one Sam's Club, two Carrefour stores and one Metro store. Tesco is also aiming at this market. Carrefour was the first to open with two supermarkets in Fuzhou. Wal-Mart opened its first Fuzhou store about 10 years ago. Metro opened its first store in South China in Fuzhou. All of these retailers carry import food items, especially import fruits from all over the world. U.S. Washington apples, seedless table grapes, and Sunkist oranges are available in almost every supermarket, including local retailers such as Xinhudou and Yonghui. U.S. imported grocery items such as canned soup and vegetables, seasoning products, olive oil, cereal, syrup, cookies, infant formula, dried raisins, almonds, jam, and instant-coffee are also available. Organic and natural products such as 100 percent natural juices, pancake mix, and energy bars with various flavors are becoming the new highlights on shelves.

Xiamen

Xiamen is highly competitive and booming. The retail sector has several international retailers, including three Wal-Mart stores, one Carrefour store, four Trust-Mart stores and one Metro store. Local retailers New Huadu and Minkelong also have found niche markets. In addition to hypermarkets, the city has several convenience stores and community stores such as Beatrice, Tunnel 88, and Yes. A select group of Xiamen consumers are willing to pay a 10–20 percent premium to try import products.

However, the more prevalent cost-conscious customers are driving retailers to offer more competitively priced local products. Still, a limited amount of import food products like Sunkist lemons, Washington's Red Delicious and Granny Smith apples, Thai rice, and Italian olive oil are available on store shelves.

With the rapid expansion of Xiamen's retail, restaurant, hotel, and tourism sectors, as well as higher income levels, the Xiamen market is expected to present more opportunities for U.S. agricultural products in years to come. Imported alcoholic beverages and selected snack foods have good potential. However, U.S. products need to differentiate themselves from competitors through pricing, unique attributes and/or strong product support in this highly competitive market. A well-defined market plan plus commitment to long-term strategy and market promotion are key.

Nanning

Nanning is the land of import food opportunities with a total population of around 6.5 million, among which 2.5 million are urban residents. The city has a medium-sized integrated iron and steel complex, a sugar refinery, other food-processing plants, and factories involved in fertilizer, machine tools, paper, cement, and farm machinery production. The high volume of liquidity in Nanning has driven greater demand for imported retail food items.

The city is connected to Vietnam by the Hunan-Guangxi railway and is the regional headquarters for trade with Southeast Asian countries. In 2008, China initiated construction on a high-speed rail line from Nanning to Guangzhou. When complete, the line will link the Pan-Pearl River Delta and southeast China with members of the ASEAN (Association of South East Asian Nations), and travel time between the two cities will drop from 13 hours to 3.

The food retail industry has rapidly developed. The city is now home to 15 local Likerong stores, 10 Nancheng Department Stores, 5 Hualian supermarkets, 4 Renrenle stores, 2 Wal-Mart stores, 2 Dream Island Department Stores, 1 Parkson stores, plus 1 newly-opened CR-Vanguard store, and a Mix-City high-end Shenzhen-style mega mall, which is under construction.

U.S. fresh fruit can be found in almost every supermarket, though there is still room to promote packaged food items. This market is in its infancy and requires in-depth research and analysis, as well as continued efforts to nurture it. For many U.S. imports, Nanning is a new market full of curious customers who have recently become affluent but lack knowledge of foreign foods.

Guilin

Guilin is a national tourism hotspot with a population of 4.8 million, 1.8 million of which are urban residents. Guilin's per capita GDP was estimated at \$2,858 in 2009, which ranked Guilin as a middle class city (125th among 659 Chinese cities surveyed by China's Ministry of Statistics). In 2008, Guilin received 1.2 million visitors, among which 814,409 were foreigners, thus making Guilin one of the most visited cities in China. The city's key retailers include Niko Niko Do, Nancheng Department Store (with 2 outlets), Renren Le, and Wal-Mart.

Niko Niko Do is a Japanese department store that has been the market leader in food retail sales since it opened its doors to the public in 1997. There are over 20,000 SKUs neatly displayed in the supermarket

shelves. Among them, import biscuits, candies, condiments, cheese, juices and wines as well as fresh fruits mostly from England, France, Chile, and Australia are arranged in designated import food sections. These products strongly compete with U.S. food items. Because of Niko Niko Do's convenient location in the city center, most tourists shop there on their way to Yangsuo, the area's major tourist attraction. With daily sales during peak months at about \$2 million, Niko Niko Do is as high of a performer as some of the multi-national stores located in Shenzhen or Guangzhou. After 13 years of operation, Niko Niko Do will soon merge with a Dalian Company. The merger is expected to be complete in two years. The Japanese manager expressed great interest in promoting U.S. food and culture in the near future.

After two store openings in the Guangxi capital of Nanning, Wal-Mart finally opened its first store in Guilin in 2009. The Guilin store is located in the northern city quadrant where the local residents have relatively lower income levels and the average per ticket sale is around \$5.50. Nevertheless, Wal-Mart is building brand recognition for many U.S. food items. Most of the imported items are currently coming from Japan, Korea, and Malaysia. U.S. food items are comparatively few but include some snacks (Sunsweet Prunes, Del Monte sauces, and Heinz Vinegar), a decent U.S. cheese section (various flavors of Land O' Lakes cheese products), and fresh fruits (Washington apples, Sunkist oranges and lemons). However, the Guilin Municipal Government plans to move part of its institutions into the northern part of the city within two years. This move would immediately triple the property values in the area and certainly increase Wal-Mart's market share.

Nancheng Department Store strategically expanded its operation from the Shenzhen market into Guangxi in 2002. According to industry insiders, Nancheng earned a favorable reputation amongst local consumers for its maintenance of fresh produce and free parking, since many local high-income consumers drive to the store. After eight years in operation, the company now boasts over 23 stores in Guangxi Province alone, 2 of which are in Guilin, and 4 in Shenzhen. Liuzhou, Guangxi province's industrial city located between Nanning and Guilin, also has over 4 retail outlets. The first Guilin Nancheng Store opened in 2004 offering over 350 free parking areas. The Nancheng group is aggressively expanding with 5-6 new stores opening by the end of the year.

Food accounted for over 55 percent of the total sales. In addition to U.S. fresh fruits such as Red Delicious, Gala, Granny Smith, and table grapes, there are U.S. prunes, raisins and cranberries as well as Hunt's ketchup and other brands on store shelves.

Haikou

Haikou, the capital of Hainan province, has a population of 2 million. Hoping to facilitate trade with other provinces, Hainan invested heavily in infrastructure and introduced duty free policies in 2011.

Currently, the city has two RT-Mart stores and three Carrefour stores, plus a local supermarket chain named "Champion," and three state-owned department stores. All stores carry U.S. imported fresh fruits such as Washington apples, Sunkist oranges and lemons, and California table grapes and plums. There are also grocery items from South-east Asia, Australia, and Germany. However, few are from the United States at this moment. The wine market is dominated by French selections. The price ranges from \$20 to \$700 per bottle. The most popular ones are below \$25.

The city also has a 300 square meter specialized import store operated by a trader. The store features 300 SKUs of wine, chocolates, nuts, milk, snacks, candies, dried fruits, and juices. Most of the food is from Australia, New Zealand, and Germany, as well as from South East Asia. More than 18 similar stores are expected to open in the next five years.

In addition, Pagoda, a fruit store chain, opened its first Haikou outlet in 2010. Sales that year were 20 percent higher than initial projections. Accordingly, Pagoda opened 2 more stores in 2011 and plans to open another 20 stores in the coming years.

High volume imports coming into Haikou rely on Guangdong distributors. Accordingly, transportation and cost control is a major issue to Haikou buyers.

Hainan Airline Group plans to invest in retail development projects in the coming years. Among them, two projects include a 400,000 square meters plaza and another 500,000 square meters project in the west of Haikou.

Chengdu, Chongqing and Southwest China

Chengdu, Chongqing, Kunming, Guiyang and Southwest China

One in every 33 people on earth lives in Southwest China. With a population of about 200 million and a regional gross domestic product (GDP) of \$579 billion in 2010, the highest gross domestic product (GDP) growth rate in the world, the area is 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.

<i>Southwest China Region Info (2010)</i>								
<i>Provinces/Cities</i>	<i>Population (Million)</i>	<i>GDP (USD Billion)</i>	<i>GDP Growth</i>	<i>Per Capita GDP (USD)</i>	<i>Per Capita Disposable Income (USD)</i>	<i>Per Capita Disposable Income growth</i>	<i>Per Capita Expenditure on Food (USD)</i>	<i>Per Capita Expenditure on Food Growth</i>
<i>Sichuan</i>	80.45	269.36	21.44%	3,348.17	2,423.38	16.27%	749.15	8.83%
<i>Chongqing</i>	28.85	124.23	21.37%	4,306.07	2,748.03	15.86%	785.67	9.53%
<i>Guizhou</i>	34.79	72.13	17.62%	2,073.30	2,216.73	14.43%	629.10	6.87%
<i>Yunnan</i>	46.02	113.23	17.09%	2,460.45	2,517.95	15.91%	719.98	2.98%
<i>Tibet</i>	3.01	7.95	14.98%	2,641.20	2,348.04	10.60%	759.80	5.80%
<i>SW China</i>	193.12	578.95	18.50%	2,965.84	2,450.83	14.45%	728.74	6.80%

Source: China Statistical Yearbook 2011 \$1 = 6.38 RMB

According to some estimates, middle-income consumers now represent almost 35 percent of urban population and at current growth rates will exceed 70 percent of the total population by 2015 and 80 percent by 2025. Economic growth in the provinces of Southwest China is among the highest in the world, averaging between 14 and 22 percent in 2010. Growth in the region's two largest emerging city markets (ECMs) in the region, Chengdu and Chongqing, which account for 20 percent of the region's population, remained in double digits in 2010. According to the 2011 China Statistical Yearbook, the

total investment in fixed assets in Southwest China reached USD 453 billion in 2010, while the total amount of foreign direct investment reached USD 111.8 billion, an increase of 18.9 percent from 2009.

Rapid Growth in Value of Imports by Province			
Region	Imports (million USD)		2010 Growth in Imports
	2009	2010	
<i>Sichuan</i>	9,993.89	13,893.46	39%
<i>Chongqing</i>	3,603.37	4,834.87	34.2%
<i>Yunnan</i>	3,777.70	5,224.67	38.3%
<i>Guizhou</i>	1,199.39	1,442.75	20.3%
<i>Tibet</i>	22.26	51.50	131.4%
<i>SW China</i>	18,596.61	25,447.25	36.8%

Source: China Statistical Yearbook 2011

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, and marketing dollars go further because of the lower level of foreign competition in Southwest China compared to more developed markets. Finally, 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.

There are three main channels for distributing products to Southwest China: local distributors who purchase product from port cities and then sell to retailers; regional distribution centers, normally associated with a single retailer; and importer direct, when retailers often working with a referred importer bring products directly from the port. Regional distribution centers are responsible for purchasing and logistics for regional and national stores. Importers direct tends to be exercised by chains with less national presence, like Ito Yokado or Renhe Springs, or with highly perishable products.

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

managers. Metro uses this model. Retail chains with more centralized purchasing systems give local store managers less control over which imported products are on their shelves. The less centralized retailers give their local managers more control of what products are in stores, but often what is available is still determined by regional or national hubs. Carrefour and Auchan fall into this model.

Southwest China Hypermarket Retailer Distribution (2011)					
Retailer	Ownership	Chengdu Outlets	Chongqing Outlets	Kunming outlets	Guiyang Outlets
Carrefour	French	7	6	7	1
Metro	German	1	1	1	0
Ito Yokado	Japanese	5	0	0	0
Isetan	Japanese	1	0	0	0
Auchan	French	5	0	0	0
Wal-Mart	USA	3	10	6	3
Wang Fujing	Chinese	2	2	1	0
Far East	Taiwanese	1	1	1	0

Renhe Spring	Chinese	1	0	0	0
Parkson	Taiwanese	1	0	2	4

Lower-end hypermarkets and supermarkets tend to use local distributors for their products. Local distributors provide more favorable terms with retailers, including paying slotting fees and selling products on credit. As a result, local distributors are reticent to offer unfamiliar foreign products with unknown market potential. This, combined with the reduced purchasing power of low end retail consumers, makes breaking into the lower-end segment of the retail sector difficult. Wal-mart falls into this model.

The majority of imported meats are purchased by retailers or their distribution centers directly from port city importers. Most imported meat is frozen. Imported fresh fruits and vegetables frequently are handled by local wholesalers. While produce is generally locally purchased, some is purchased direct from importers. Imported processed foods are the most likely to go through local distribution channels, especially when there is no central distribution system. These local distributors will often arrange more favorable terms of agreement than central distributors in port cities, for example return of expired or unsold products. They often work on commission. In addition, local distributors tend to promote imported products through retailers to increase product sales.

Key obstacles include logistics and knowledge of how to use new-to-market products. The distance from major port cities such as Shanghai, Guangzhou, 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.

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

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.

Chongqing is growing rapidly, but incomes have not risen to the levels of Chengdu yet, so it has a smaller consumer base. Metro in Chongqing has large contracts for imported products with Yangtze riverboat tours.

Kunming, the capital of Yunnan province, serves as a transportation hub in Southwest China and a popular tourist destination for mainland Chinese. It is quickly becoming one of China's most promising second-tier retail markets and has a growing concentration of foreign retailers.

Guiyang, the capital of Guizhou province is often recognized as being one of the poorest provinces in China. Nevertheless, Guiyang's youth tend to save less and prefer to spend their earnings on dining out and fashionable clothing. Guiyang has a bustling retail sector boasting a large number of malls and shopping centers home to international luxury and fashion brands.

Northeast China

Northeast China includes three provinces, Liaoning, Jilin and Heilongjiang, which together are known as The Northeast. Major cities include Shenyang, Dalian, Changchun and Harbin, all with several million inhabitants. It covers more than 800,000 square kilometers and has a population of 107 million. This region's GDP of 2010 was RMB 3.71 trillion (US\$ 589 billion).

As China's traditional industrial base, focusing mainly on equipment manufacturing, the Northeast is one of the earliest regions to industrialize in China. However, since the late 1980s, it has seen the transition from an economy based almost solely on heavy industry to a more diverse one, including light industry, as China's economy began to liberalize and privatize. In August 2009, Chinese government initialized a program called "Revitalize the Northeast" to turn this region into one of China's economic growth engines.

Almost all the famous multinational retailers, including Wal-Mart, Carrefour, Metro and Tesco, have stores here in the Northeast. With share of less than 5 percent in these places, imported food still has much room to grow.

City Profiles

Shenyang

Shenyang, the capital of Liaoning Province, is the largest city in northeast China. During China's Planned Economy era, Shenyang was well known over China for its heavy industry. The permanent resident population is currently 8.1 million, and has grown by nearly one million people over the past ten years, making it the fourth largest city in North China.

Shenyang plays a key role in the northeast revitalization. Its GDP of 2010 was RMB 501.7 billion (US\$ 78.39 billion), up 14.1 percent over the previous year, the sixteenth largest in China. Since 2001, Shenyang's GDP has quadrupled with an annual growth rate of 16.8 percent. According to Shenyang's 12th Five Year Plan, the city's GDP is forecast to grow at 12 percent per year over the next five years.

With double-digit economic growth, the city's average disposable income has increased dramatically in recent years. In 2005, urban per capita disposable income was RMB 10,098(US\$1600); by 2010, it has doubled to RMB 20,541(US\$3260), which is expected to grow 13 percent per year during the 12th five-year Plan.

Shenyang's retail market is mostly concentrated in the traditional downtown shopping areas, and in the new shopping centers constructed in Shenyang's Hunnan and Shenbei Districts. Retail sales have been growing rapidly, increasing on average by 10 percent per year over the past five years, and hitting RMB

206.5 billion(US\$32.77 billion) at the end of 2010, an increase of 18.5 percent year on year. A number of international chains have set up supermarkets in many of the city's major residential areas, and these stores are now leading the development of local community retail markets. Wal-Mart has opened four stores in Shenyang, Carrefour nine and Tesco six. Lotte Mart opened its first store in Shenyang in 2011.

High-end supermarkets in Shenyang

Ole, the high-end supermarket under the Chinese conglomerate China Resources has opened its first store last May in the MixC, one of Shenyang's newest and most prominent retail concepts. The imported items in Ole account for more than 60 percent, others are premium domestic products.

Yoo Hoo, a local high-end supermarket, was opened at the end of 2010. With over 7,000 square meters, it is one of the largest high end supermarkets in the northeast, even China. Many of the top management were recruited from Hong Kong and its imported items account for 70 percent of the total.

Charter and Isetan are two other smaller high-end supermarkets in Shenyang.

Dalian

Dalian is a major city and seaport in southern Liaoning Province. It is the southernmost city of Northeast China and China's northeastern most warm water port. As the second largest city of Liaoning, next only to Shenyang, Dalian has had a continuous annual double-digit percentage of GDP growth rate since 1992 and had the highest GDP in Liaoning in 2010, hitting RMB 515.8 billion (US\$ 80.59 billion).

Owning four stores and a newly opened Sam's Club, Wal-Mart has been developing very fast in Dalian, followed by three Carrefour stores and three Tesco stores.

Dashang Group, headquartered in Dalian, operates Dalian Market in central Dalian that includes New Mart department store, super market, Jiajia Square, Dalian Mykal and Sheng 1000, even with an online shop. Operating more than 150 retail stores in China, Dashang Group is the largest retailer in Northeast China.

Changchun

Changchun, the capital and largest city of Jilin Province, was designated to become a center for China's automotive industry since the 1950s. With a population of over seven million, Changchun achieved a GDP of RMB332.9 billion (US\$ 52.84 billion) in 2010, representing a rise of 15.3 percent year on year.

The competition among supermarkets is fierce in Changchun. Tesco closed its two stores in Jilin City and Changchun in 2007 and 2008 respectively. The same happened to one of the Carrefour stores early last year.

Changchun Eurasia Shopping Center, with over 560,000 square meters, is the biggest stand alone shopping center in the Northeast and among the largest in all of China. It has planned to increase the operation area by 700,000 square meters in the 12th five-year Plan, which may make it the largest stand alone shopping center in the world.

Harbin

Harbin, the largest and the capital city of Heilongjiang Province, is famous for its cold winters. The annual Ice and Snow Festival has been attracting millions of tourists to this city since its beginning in 1985. Harbin achieved a GDP of RMB366.59 billion (US\$ 58.18) in 2010, an increase of 14.0 percent over the previous year.

Besides five Carrefour stores, three Wal-Mart stores and three Trust Mart Stores, Harbin has quite a few shopping centers, such as Yuanda, Songlei, Mykal and Charter. The supermarkets in these shopping centers carry approximately 20 percent imported food.

Intellectual Property Rights

We would like to encourage you to sell quality products in China and to market them exceptionally well. Of course those who intend to copy your product encourage you to do so as well. The fact that you have a quality product means that your brand has value. Counterfeit products deprive you of that value by competing for sales with your products and harming your reputation. Counterfeit products may also be exported from China, affecting you in other markets. Protecting intellectual property is a critical part of doing business in China. Avoiding infringement requires patent, copyright, or trademark registration with the appropriate Chinese registration office. Companies must also be proactive in pursuing enforcement mechanisms available to halt infringers.

Ideally, IPR protection should begin prior to when companies or trade associations begin exploring the China market for their food or beverage goods. Interested parties should also recognize the importance of registering and protecting trademarks in both English and Chinese languages, including obtaining collective marks for U.S. collective organizations and USDA Cooperators or certification marks. Interested parties are strongly encouraged to review the U.S. Embassy's "China IPR Toolkit" and FAS Beijing on-line reports CH7028, containing information on China's patent, trademark and copyright legislation and enforcement and CH4078 and 7088, on plant variety protection.

Appendix

Table 1:

Selected International Retailers in Regional Markets Number of Hypermarkets and Supermarkets by Province or City	
East China	

	Shanghai	Zhejiang	Jiangsu	Anhui	Jiangxi	Hubei
Carrefour	22	8	25	8	1	8
Wal-Mart	12	17	22	15	9	15
Metro	5	5	12	1	1	2
Tesco	21	15	16	3	0	0
RT-Mart	14	19	46	10	3	2
Auchan	6	9	20	3	0	0
Lotus	24	1	6	1	0	3
North China						
	Beijing	Tianjin	Qingdao	Zhengzhou	Xian	
Carrefour	18	5	3	3	0	
Wal-Mart	7	2	2	3	6	
Sam Club	2	0	0	0	0	
Metro	3	1	1	1	1	
Jusco	2	1	3	0	0	
RT-Mart	1	2	2	1	1	
Tesco	4	6	1	0	0	
South China						
	Guangdong	Fujian	Hunan	Guangxi	Hainan	
Wal-Mart	38	13	9	4	0	
Trust Mart	28	12	1	0	0	
Sam's Club	2	1	0	0	0	
Carrefour	20	5	4	0	3	
Metro	8	2	1	0	0	
Tesco	9	3	0	0	0	
Jusco	19	0	0	0	0	
RT-Mart	22	6	4	2	2	
Southwest China						
	Chengdu	Chongqing	Kunming			
Carrefour	7	6	5			
Metro	1	1	1			
Ito Yokado	5	0	0			
Isetan	1	0	0			
Auchan	5	0	0			
Walmart	3	10	6			

Source: FAS China Research

Selected International Retailers in Regional Markets
Number of Hypermarkets and Supermarkets by City

Northeast

	Shenyang	Dalian	Changchun	Harbin
Carrefour	9	3	2	5
Wal-Mart	4	4	4	3
Trust Mart	0	3	0	3
Sam's Club	0	1	0	0
Metro	1	1	0	1
Tesco	6	3	0	0
RT-Mart	2	0	1	3
Isetan	1	0	0	0

Table 2:

Top Players in Shanghai Retail Total Number of Locations, Year End 2011	
Company	Number
Lianhua	3,320
Carrefour Hypermarket	22
RT-Mart	14
Nonggongshang	2,125
Hualian	920
Lotus	21
Metro	5
Hualian GSM	21
Shanghai Homegain	131
Jieqiang Tobacco, Sugar & Wine	209
Auchan	3
Watson	82
Jiajiale	5
Tesco	21

Source: Shanghai Statistical Yearbook, 2011

