USDA Foreign Agricultural Service
GAIN Report
Global Agricultural Information Network

Required Report - public distribution

Date: 4/1/2019
GAIN Report Number: GAIN0079

China - Peoples Republic of

Food Processing Ingredients

Industry Matures as it Caters To Demand for Natural, Healthier, and More Convenient Processed Foods

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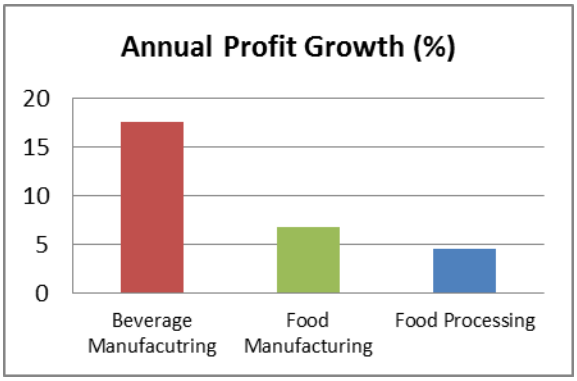
Report Highlights:
China's food processing industry is maturing, and growth is moderating. Consumers have becoming increasingly interested in eating more natural and healthier foods, while valuing convenience and attractive packaging. Food processing still accounts for 60 percent of the sector, however the fastest growth is now in the beverage sector, where the trend for natural, healthy, and convenient ready-to-drink smoothies, yogurts, and juices represents China's transition from "eating full" to "eating well." Exporters are encouraged to consider China not as a singular market, but a country with regional differences and culinary traditions affecting how their product will be received. U.S. fruit ingredients (processed, and some fresh), dairy, pork, and some specialty grains and legumes have the best food processing sales potential.

Food Processing Fact Sheet: China

Executive Summary

China's food processing industry grew by 6.3 percent in 2017, however growth is expected to slow in 2018 and beyond due to industry consolidation, a decelerating economy, and global economic uncertainty. The industry has split its focus by continuing to provide traditional processed foods to mostly rural and older consumers, while innovating exciting snacks and beverages using higher quality ingredients for younger affluent urban consumers.

Industry Overview



Beverage manufacturing profit increased 17.5 percent, while food manufacturing grew at a more modest 6.7 percent, reflecting urban middle class consumer interest in higher quality snacks and beverages.

Production, Imports, and Exports

China's food processing industry is largely dependent upon sourcing domestic food ingredients for domestic consumption. A relatively small industry segment relies on imported food ingredients. Food exports account for only 4 percent of industry output.

Processing Channels (USD billion) 2017[1]

Food Industry Output	$1,470
Food Exports[2]	$62.6
Food Imports	$54.3
Inventory	$20.1

Quick Takeaways for Exporters

- New market entrants should consider attending trade shows, especially Food Ingredients China (FIC), held each March.
- In 2018, China reorganized its customs and regulatory agencies - The FAIRS Narrative and Certificate reports outline how this reorganization might affect exporters.
- The beverage manufacturing and food manufacturing sectors are growing the quickest – as they cater to mostly younger, urban, affluent consumers with higher-end "healthy and fresh" processed foods.

Strengths/Weaknesses/Opportunities/Threats (SWOT) Analysis	
Strengths	**Weaknesses**
U.S. food ingredients are regarded as high quality, consistent, and safe. Higher quality ingredients are increasingly sought after by consumers.	Increased tariffs on U.S. products affect competitiveness with other exporting countries.
Opportunities	**Threats**
Younger generations are more accustomed to eating processed foods. Streamlined imports directly to food processors and retail chains (e.g., private labeled products)	A slowing economy, and more price sensitivity. Increasingly complex certification, testing, and facility/production registration requirements for imports.

[1] Source: China Statistical Yearbook 2018.
[2] Includes food and live animal products

SECTION I: MARKET SUMMARY

China's food processing industry continued to grow in 2017. Revenue climbed to $1.47 trillion, an increase of 6.3 percent compared with the previous year. Profit reached $118 billion, an increase of 6.3 percent compared to 2016[3]. Despite the modest growth in 2017, the food processing industry continues to slow down due to industry maturation, consolidation, and lower fixed asset investments.

In 2018, industry investment and growth was expected to further moderate, given a combination of macroeconomic factors, including global economic uncertainty, U.S.-China trade friction, and economic indicators suggesting a broad economic slowdown in China. Food processing industry publications have debated the effects that slower macroeconomic growth would have on Chinese consumers and the food processing industry. There is no clear consensus on how a slowdown (or even if one is occurring) will affect domestic consumption. In March 2019, the Chinese government lowered its gross domestic production growth target to "6 to 6.5 percent," a decrease from its 2018 target of "around 6.5 percent." Many industry insiders have argued that there is ample evidence of food consumption downgrading, such as reports that instant noodle consumption surged in 2018, after years of flat sales.

Nevertheless, China continues its transition from "eating full" to "eating well." China's fixed assets investment growth rate, an indicator measuring food manufacturing capacity growth, dropped from 37.5 percent in 2011 to 1.2 percent in 2017. This is a proxy measure for new food processing investments, suggesting that processors have the necessary equipment, facilities, and technology in place, and that growth will now come from food processing innovation and consumption upgrading, not processing capacity expansion.

The shift to "eating well" is especially true for affluent middle class consumers, who are choosing snacks, condiments, beverages, and other processed foods perceived to be healthier than traditional options. The food processing and retail sectors must balance mostly rural and older consumer demand for traditional snacks, instant noodles, and beverages, and the more affluent urban younger consumers demand for new products, imported indredients, and healthier snacks and beverages.

Table 1. Advantages and Challenges for U.S. Food Processing Ingredients

Advantages	Challenges
Fast paced and increasingly urbanized lifestyles are driving consumers to eat more processed foods.	A slowing economy coupled with increased tariffs on U.S. imports, make U.S. food ingredients comparatively expensive.
Younger generations are more accustomed to eating processed foods.	Much of the food processing sector is still dominated by antiquated state owned enterprises.

[3] China Statistical Year Book 2019.

U.S. food ingredients are commonly regarded as high quality, consistent, and safe.	U.S. products must increasingly abide by complex certification, testing, and facility/production registration requirements.
New technologies, such as automation and packaging, are rapidly improving.	Consumers appear to be becoming more price sensitive, and ingredient suppliers are hesitant to pass price increases on to consumers.

SECTION II: ROAD MAP FOR MARKET ENTRY

Entry strategy

New food ingredient exporters should begin their inquiry by reading two important annual USDA FAS reports. The China Exporter Guide will help exporters better understand how their food ingredient products fit into the larger China market, and will provide readers with key market access information, market entry strategies, import procedures, and consumer demand trends. The Food and Agricultural Import Regulations and Standards (FAIRS) Narrative report for China provides comprehensive information on product specific important regulations and standards, and also includes information related to product testing, packaging, and production facility registration requirements. The FAIRS Certificate report provides a brief but complete outline of the import certificates and other documents needed to import U.S. products into China. It is also vitally important to bear in mind that while China is one country, is still very diverse in regards to geographical regions, dietary preferences, urban-rural consumer class dynamics, local government incentives, cold chain/logistics capabilities, and many other factors. Exporters are encouraged to first target one city/region in which to introduce their products to distributors/importers before considering an all-China export plan.

To enter the market, U.S. exporters have several options:

- Attend trade shows in China to gain market information, gauge interest in your product(s), observe competitors, and meet potential Chinese partners. Depending on the product, we recommend several high-quality exhibitions. Food Ingredients China (FIC) is perhaps the best targeted show for food ingredient exporters. Other shows include Food & Hotel China (FHC), the China Fisheries & Seafood Expo, SIAL China, the China International Meat Industry Expo, Bakery China Show, and China Food & Drinks Expo (also known as *Tang Jiu Hui*). Exporters should also consider attending major Hong Kong based trade shows, all of which attract Chinese importers and distributors, such as Asia Fruit Logistica and HOFEX.
- Participate in State Regional Trade Group (SRTG) activities, such as trade missions to China. Trade missions typically include site tours of processing facilities, one-on-one meetings with importers, exhibiting under a unified USA pavilion at trade shows, and attending exporter training and education events.
- Work with state departments of agriculture and/or state trade promotion offices, and participate in trade missions and activities similar to those organized by SRTGs.

- Connect with non-profit food and agricultural trade associations (i.e., FAS Cooperators), who receive USDA funds each year to provide exporter assistance, sponsor trade missions, and help producers identify new market opportunities. Many Cooperators have representatives in China who can provide introductions to importers, food processors, and distributors.
- Communicate directly with Chinese food and agricultural industry associations. New market entrants are advised against using this option first, since Chinese industry associations strongly rely on well-established professional connections when providing information or introductions. However, exporters who have these connections, or those employing Chinese staff, may be able to directly leverage contacts in these associations to meet importers, distributors, and food processors.
- Contact USDA FAS Agricultural Trade Offices (ATO) in China (Beijing, Shanghai, Guangzhou, Chengdu and Shenyang), for information and trade facilitation assistance. These ATOs are strategically located in the five main commercial regions, and they can provide tailored information about their respective regions. Exporters are may learn more about ATO services by visiting www.usdachina.com.

Import Procedures

Generally, U.S. agricultural products enter China following the standard export-import model of using private customs agents to clear products at the ports, and distributors to move products to end-users. Formal import procedures as outlined by the General Administration of Customs of China (GACC) and other relevant food and agricultural regulatory authorities can differ from how private customs agents clear products through ports of entry. In the past decade, China has sought to improve public confidence in its ability to provide safe food to consumers, and thus has rather quickly passed numerous regulations, standards, certifications, and permits pertaining to food and agricultural imports. These regulations can be vague and unclear to exporters, and even to many Chinese port authorities. Even though port authorities are now under more central GACC control than in previous years, local port authorities may interpret import regulations differently. The FAIRS Narrative and Certificate reports outline official procedures, however exporters are encouraged to discuss specific questions with experienced importers who can provide on-the-ground advice.

Distribution Channels and Market Structure

China is generally divided into five regions:

- **South China**, which includes the cities of Guangzhou, Shenzhen, Xiamen, Fuzhou, and Nanning
- **East China**, which includes Shanghai, Ningbo, Hangzhou, Hefei, Nanjing, and Wuhan
- **North China**, which includes Beijing, Tianjin, Hohhot, Jinan, Qingdao, Lanzhou, and Zhengzhou
- **Northeast China**, which includes Dalian, Harbin, and Shenyang
- **Southwest China**, which includes Chengdu, Chongqing, Kunming, Guiyang, and Lhasa

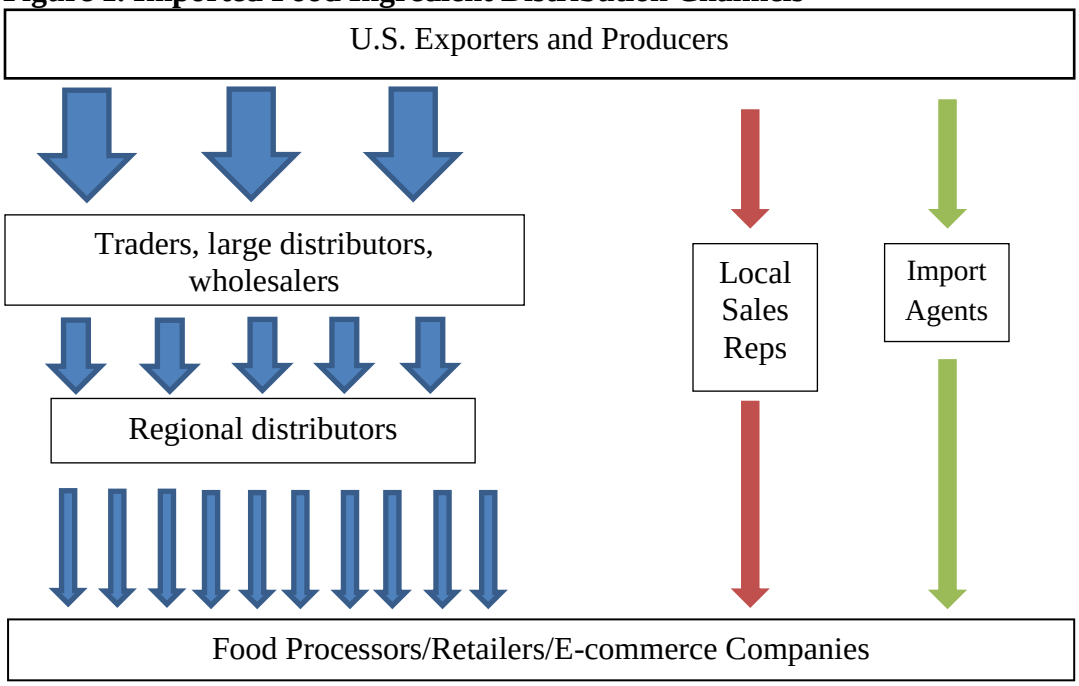
The main imported food ingredient distribution channels begin within the three major population centers and port cities of East China, South China, and North China. These three regions include at least one large first-tier city, port of entry facilities along the coast, and distribution channels, which generally lead westward into smaller second- and third-tier cities. While these three regions represent the traditional market entry channels for imported food ingredients, cities in Southwest China have some of the highest economic growth rates in the country, and the Northeast has a strong manufacturing and grain production base, which may be of interest to some food ingredient exporters.

The traditional trade pattern is for U.S. exporters to sell directly to Chinese trading or distribution companies (Figure 1, in blue). These trading companies typically have the scale, and the capital, to purchase large quantities of products and resell them to food processors and other third-party food manufacturers. Because of the immense size of China's market, these large trading companies in first-tier cities usually resell products to increasingly smaller regional food ingredient distributors, who then sell directly to local food processing facilities.

As China's economy continues to grow and modernize, there has been some disruption to this model. With better technology, market consolidation, in-house trading companies, and consumer demand for fresh and authentic imports, many Chinese food companies, restaurant and hotel chains, grocery stores, and e-commerce companies are seeking to reduce the role of the trading company (i.e., "middleman") in favor of a direct import model linking exporters with end-users (Figure 1, in green). This trend is already being seen in consumer oriented products, such as live seafood, wine, and fresh fruit, however large retail (including e-commerce) companies are increasing interested in directly sourcing food ingredients from exporters for their private label processed food offerings.

U.S. exporters may consider establishing sales offices, or contracting local sales staff, to market their products directly to large processors, manufacturers, and e-commerce platforms (Figure 1, in red). The advantage of this is that the U.S. exporters could enjoy higher profit margins by selling products directly to end users and exert tighter control over the end market. Chinese buyers could also pay less money for the same products than from upstream local distributors. This pattern normally demands more upfront monetary and time investments.

Figure 1. Imported Food Ingredient Distribution Channels



Note: Width of arrows denotes approximate volume of trade.

Major Sectors in the Food Processing Industry

The food industry is categorized into three main sectors, which include food processing, food manufacturing, and beverage manufacturing. Within each sector, the major segments as shown in Table 2.

Table 2. Food Processing Industry Sector and Segments

Sector	Segment
Food processing	rice milling, flour milling, oil refining, sugar refining, slaughtering, salt processing, aquatic products, etc.
Food manufacturing	packaged (snack) foods, pastries and confections, dairy products, canned foods, fermented products, frozen foods, condiments, flavorings, etc.
Beverage manufacturing	alcoholic beverages, soft drinks and tea, fruit juices and purees, dairy ingredients, etc.

In 2017, the beverage manufacturing sector expanded considerably more than the food processing and manufacturing sectors, although the beverage sector accounts for 17 percent of the industry's revenue (Table 3). Profit growth in beverage manufacturing is more than double the other sectors, which can be explained by the favorable margins involved in producing higher quality dairy, coffee, fruit/vegetable juice, and "healthy lifestyle" drinks marketed to affluent urban consumers. Food processing profit growth lagged behind the food manufacturing and beverage sectors, however it still accounts for 60 percent of the industry's revenue.

Table 3. Summary of Food Processing Industry Growth in 2017

Food Sector	Revenue ($100 million)	Number of businesses*	Industrial added value growth (%)**	Profit growth (%)**
Food processing	8,860	24,661	6.5	4.5
Food manufacturing	3,275	8,862	6.4	6.7
beverage manufacturing	2,529	6,714	8.1	17.5

**: Statistics are only available for firms with annual sales revenue in excess of RMB 20 million (USD$1 = RMB6.76) **: Growth rate is made on year-on-year basis. Sources: China Statistical Yearbook 2018; China Food Industry Association's internal Food Industry Summary report; China Food Industry Association's Food industry Development Status in the First half of 2018 internal report.*

Sector Trends

China continues to transition from a society that values "eating full" to one that emphasizes "eating well," especially among the growing urban middle class. This transition has, and it is expected to continue to have, profound effects on the three major food processing sectors. More traditional industry segments, especially those within the food processing and manufacturing sectors, are expected to consolidate, and growth may also slow relative to fresh and minimally processed foods (Table 4). The retail (to include e-commerce) and HRI sectors are expanding their ready-to-eat options, to include "fresh and heathy," and diet-minded foods for urban affluent consumers.

Table 4. Profit Growth of Food Sectors Jan to May, 2018

Sector	Growth Rate
Formula milk	111%
Fruit and vegetable beverages	79%
Carbonated beverages	54%
Sugar processing	-45%
Alcohol	-55%
Other dairy products	-60%

Source: China Food Industry Association's Food industry Development Status in the First half of 2018 internal report.

SECTION III. COMPETITION

Since 2018, trade friction between the United States and China affected the competiveness of many U.S. products. Furthermore, several key food ingredient exporting countries (e.g., Australia and New Zealand) have signed free trade agreements with China, further eroding U.S. competitiveness. Despite increased competition and higher tariffs, many U.S. food processing ingredients remain in demand, although opportunities may not be immediately apparent. For example with respect to dairy ingredients, the United States exports skim milk protein, and high and low protein whey concentrates. China tariffs on U.S. skim milk protein is approximately 30 percent and low protein whey concentrate is assessed duties of at least 25 percent. The

competitiveness of these two U.S. products decreased considerably, since traders can now source comparable products from New Zealand, Australia, Poland, and Russia. However traders report that U.S. high protein whey concentrate, which are assessed duties of five to 10 percent, is still very much in demand by food processors. Fresh and dried fruit for processing is another case. While U.S. fresh fruit exports have decreased due to higher tariffs, some products that processors are unable to source elsewhere are still competitive, for example frozen/dried blueberries, dried cranberries, and tart cherries.

SECTION IV. BEST PRODUCT PROSPECTS

Products Present in the Market which have Good Sales Potential

Lentils and other Specialty Crops. Since gaining market access in 2016, U.S. lentils have expanded from zero to 10,599 metric tons (MT) in three years, accounting for 80 percent of China's lentil imports. Lentils are a good example of products that China used to produce in abundance, but due to increased feed and forage crop acreage, they are no longer produced to the same degree in favor of imports.

Dairy Ingredients. Whey, skim milk powder, cheese, and other dairy ingredients are in high demand, since China is not able to produce them in sufficient quantities and quality. U.S. high protein whey concentrate, which is used to fortify beverages and yogurts, are especially in demand due to lower assessed tariffs. The competitiveness of most other U.S. dairy ingredients is currently restricted by high tariffs.

Fruit Ingredients. Frozen/dried fruits, such as blueberries, cranberries, and tart cherries have great potential due to the specific attributes of U.S. varieties. While China can source fresh blueberries from Chile and Peru, U.S. blueberries have a higher sugar content and softer skin which are sought after by food processors, especially for use in beverages and yogurts.

Pork. African Swine Flu has taken a toll on China's swine and pork production. To cover an estimated domestic supply gap and ease consumer's concerns, China is expected to increase pork imports by up to 33 percent, or 2 million MT, in 2019. U.S. pork products face Chinese tariffs of up to 62 percent. If tariffs are lowered, U.S. producers could significantly increase exports.

Products Not Present in Market but which have Good Sales Potential

Fruit Ingredients. Table 4 demonstrates the increasing profitability of the beverage sector in China. As a result, fruit ingredients are increasingly sought after by beverage manufacturers for coloring and flavoring. U.S. fruit ingredients, such as raspberry, peach, and blueberry do not have market access for fresh products, however many fruit ingredients can be imported frozen, powdered, or in their dried whole form.

Specialty Crops. Traditionally, China produced many specialty grain and legumes, but due to structural changes favoring planting feed and forage crops, China's strength in specialty crops has reduced significantly. If U.S. products can be granted access, these niche crops, such as garbanzo and millet, may find surprising demand by food processors unable to source better quality imports elsewhere.

Products Not Present Because They Face Significant Barriers

Poultry. Imported poultry products are in high demand, particularly products like chicken feet that have little commercial value in the United States. U.S. imports are excluded by China's avian influenza import restrictions.

Non-GMO (Food-Grade) Soybeans. Although U.S. non-GMO (food grade) soybeans can be imported, they are traded in limited amounts due to China's zero tolerance policy for the presence of biotech in a food-grade soybean shipment. Traders and processors are hesitant to import U.S. non-GMO food-grade soybeans for fear that an entire shipment will be denied entry if a trace amount of biotech soybeans are detected. Chinese domestic supply is far from being sufficient. Expanding U.S. non-GMO food-grade soybeans is contingent upon China approving a low level presence policy to address incidental contamination.

SECTION VI. KEY CONTACTS AND FURTHER INFORMATION

For more information about food and agricultural import regulations and standards, please contact:

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U.S. Embassy in Beijing
Phone: (86-10) 8531-3600
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For more information about this report and food ingredient marketing opportunities in North China, please contact:

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