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## **China - Peoples Republic of**

## **Food Processing Ingredients**

## **2010 Annual Report**

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**Report Highlights:**

Despite the ongoing global economic crisis, Chinese GDP growth reached 8.7 percent in 2009. Its food processing industry was minimally affected by the downturn and achieved a new record high output of RMB4.5 trillion (\$662 billion). China's continuing growth, increasing disposable income, expanding emerging city development, growing urbanization, rising interest in food safety and interest in new foods are expected to continue generating major opportunities for high quality U.S. food ingredients.

**Post:**  
Beijing ATO

**Executive Summary:**

This annual report reviews development of China's food processing industry in 2009 and examines trends and prospects for 2010.

The ongoing global economic crisis has created many challenges for China and other major economies. In China, these problems manifested itself in the closure of many small and mid-sized companies in the coastal provinces, reduced FDI, and falling customer visits to high end hotels and restaurants. However, thanks high growth in the interior and a large Chinese government stimulus of \$588 billion, China ended up with 8.7 percent percent growth in 2009.

China's food processing industry was minimally affected by the economic downturn and maintained its rapid growth in 2009, continuing its 30 year old rapid expansion. The total output value in 2009 reached RMB 4.5 trillion (\$662 billion), up nearly 20 percent from 2008. By the end of 2008, China has more than 30,000 large food processing companies. Including small processors, the total number is believed to be around 500,000. At the same time, foreign trade value on food in 2008 hit \$86.5 billion, nearly 40 percent higher than 2007.

Despite rapid development over the past three decades, China's food processing industry is still in its infancy compared with developed countries. For example, most processed food production is still fairly basic and focused on primary activities such as milling and animal slaughter while little value is added in the manufacturing process. The ratio of processed output value to agricultural production value is a widely used benchmark to evaluate the maturity of a country's processing industry. More value-added in means indicates a more developed processing sector. While China is only 1:2, it is 3:1 in developed countries. There is tremendous room for expansion.

The food processing sector has been growing at an annual average growth of nearly 30 percent from 2003 to 2009, which is faster than food manufacturing and beverage manufacturing, growth. In China, food processing covers primary activities such as rice milling, flour milling, oil refining, slaughtering, and aquatic product processing while food manufacturing covers packaged food, pastries and confections, dairy products, canned foods, and condiments; and beverage manufacturing relates to the production of alcoholic beverages, soft drinks and tea.

Over the years to come, it is expected that food processing industry will keep evolving rapidly, mainly fueled by rising disposable income and accelerating urbanization. The Chinese diet will continue moving away from the conventional fresh food and wet markets to the more western type packaged food and hyper market. Chinese are getting used to frequent dining-out and eating dairy foods while the young and white collar workers prefer frozen and convenience food. At the same time, young parents seek out high quality baby food while the elderly also are interested in healthier foods. More generally, food safety has become a major concern for Chinese consumers because of the melamine-contaminated infant milk powder scandal and other problems. For experienced U.S. exporters who prepare carefully and have the right products, the China market provides almost unlimited opportunities.

*Note: RMB is converted into U.S. dollars at prevailing rates in effect during data collection periods. In 2007,*

*\$1 = RMB7.6; in 2008, \$1 = RMB6.95; and in 2009, \$1 =RMB6.8.  
Data used is the most recent available – which can be from 2007, 2008 or 2009.*

**Author Defined:**

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### SECTION I MARKET SUMMARY

#### 1.1 Market Overview

China was not immune to the 2008 global recession, although it was less affected than most countries. Strong growth in the interior and a substantial stimulus package kept 2009 GDP growth at 8.7 percent, down only one percent from the year before.

In the food industry, the impact was even less. Reasons behind this include: a) China was damaged by the downturn than other major economies; b) The food industry is less sensitive to economic recession compared to other industries; c) The industry benefited from positive measures adopted by the Chinese government, including the Four Trillion Stimulus Plan (equivalent to about \$588 billion).

With the world economy recovering gradually and China developing rapidly, China's food processing industry is expected to maintain high growth in the coming years. This should continue driving demand for imported food ingredients higher.

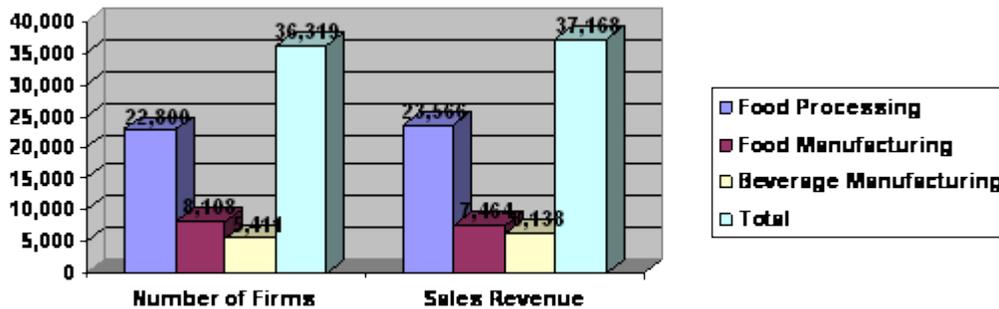
##### 1.1.1 Market growth

Official Chinese statistics separate its industrial food production into three categories, including:

- **Food processing**, includes primary activities such as rice milling, flour milling, oil refining, sugar refining, slaughtering, salt processing, feed processing, and aquatic product processing;
- **Food manufacturing**, consists of packaged food, pastries and confections, dairy products, canned foods, fermented products, and condiments; and
- **Beverage manufacturing**, which is the production of alcoholic beverages (i.e., distilled spirits, beer and wine), soft drinks and tea.

**Figure 1: Food Processing Industry, Number of Firms & Sales Revenue, 2009**

(Sales Revenue in RMB 100 million)



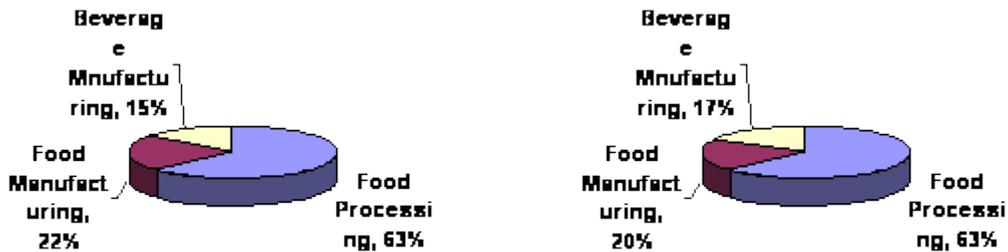
Source: China Statistical Yearbook, 2009

\* Statistics are only available for firms with annual sales revenue in excess of RMB 5 million.

\*\* 1 US\$ equals to RMB 6.95 in 2008.

With over 36,000 major processors and sales of worth RMB 3.7 trillion (\$532 billion), the data portray a large food processing industry in China. However, the reality is that the industry is even larger than it looks above because the data do not include firms with annual sales revenue of less than RMB5 million (\$720,000). Most industry sources put the number of firms at 500,000, bringing 2009 total industry sales close to RMB4.5 trillion (\$659 billion). Although these small companies account for 93 percent of firms, they only account for 19 percent of total sales.

**Figure 2: Number of Firms and Sales Revenues in Sectors in Percentages 2008**



Source: China Statistical Yearbook, 2009

\* Statistics are only available for firms with annual sales revenue in excess of RMB 5 million

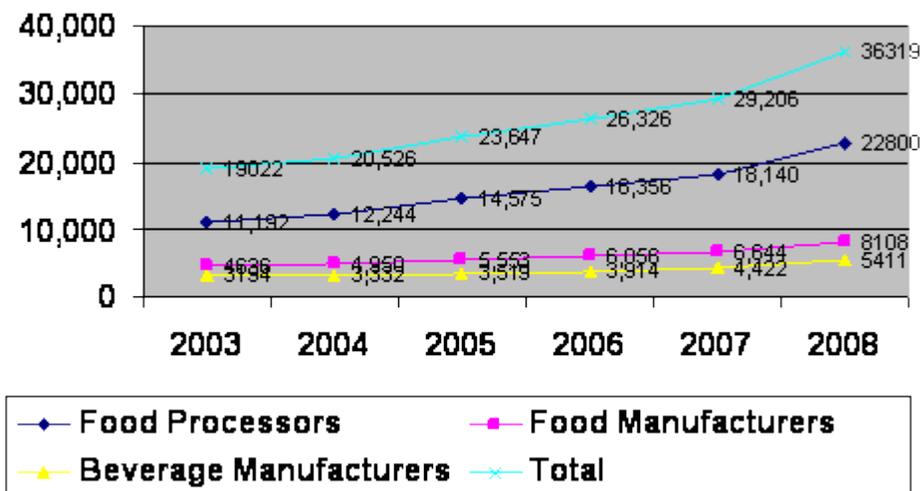
Despite its immense size, China's food processing remains focused on primary processing of agricultural products, such as milling, animal slaughter and refining. In terms of both number of firms and sales revenue, the sector accounts for 63 percent of the total industry, far higher than the share in developed countries. The other

sectors, including food manufacturing and beverage manufacturing, jointly account for only 37 percent of revenues.

This reflects an underdeveloped industry where small firms make up the majority but where little value is added beyond the very basic stages of food processing. As a result, China’s present ratio of processed output value to agricultural production value stays at 1:2, still far behind the 3:1 ratio of developed countries. In other words, only a third of value is added to Chinese products off the farm while in developed countries, 75 percent is off-farm added value.

The fragmentation of food processing, the relative dearth of value-added processing and high growth all point to great growth potential for the industry. From the U.S. exporter perspective, it means immense for potential food ingredients suppliers as China’s food industry evolves.

**Figure 3: Growth of Numbers of Firms in Food Processing Sectors 2003 - 2008**



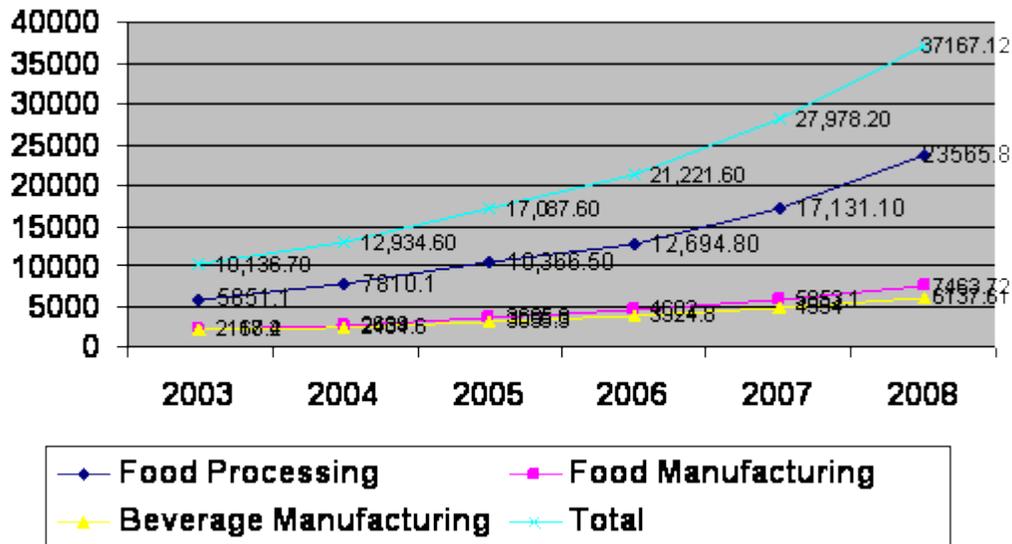
Source: China Statistical Yearbook, 2009

\* Statistics are only available for firms with annual sales revenue in excess of RMB 5 million

China’s food processing industries are booming. Over the past five years, number of firms grew by 13.8 percent annually. This expansion was driven by a continuously rising demand for processed food products and the relative ease of establishing a food operation because of low capital and technical requirements. Although this expansion has contributed to a more open, competitive and dynamic industry, it has complicated food safety standards enforcement.

This rapid expansion of firms is likely to be curbed soon. The newly released Food Safety Law, following repeated food safety scandals, took effect from June 1, 2009 is has lifted the entry bar higher for food operations.

**Figure 4: Growth of Sales Revenue in Food Processing Sectors 2003- 2008 (RMB100 million)**



Source: China Statistical Yearbook, 2009

Sales growth is impressive. The figure above depicts that the average annual growth of sales revenue is close to 30 percent annually. In 2008, growth even hit 32.8 percent. Sales growth continues to exceed firm number growth, showing that firms are getting bigger. It is expected this will continue into the future years as scale becomes more important to competitiveness.

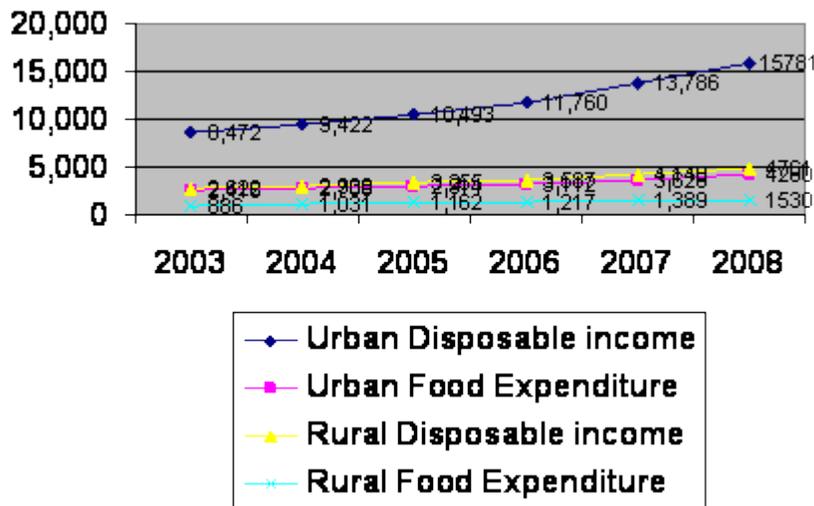
**1.1.2 Driving forces**

Disposable income and urbanization are two major drivers behind China’s growing food industry. In addition, food safety also plays a big role by driving demand for high quality food ingredients and encouraging firms to grow larger.

**Rising disposable income**

Disposable income is the locomotive behind food industry growth. Thanks to robust economic development in China, disposable income has been increasing rapidly over the past 30 plus years, fueling expansion of the food industry.

**Figure 5: Per Capita Income and Food Expenditure in China 2003-2008 (RMB)**



Source: China Statistical Yearbook, 2009

In 2008, food expenditures totaled reached RMB 4,761 for urban consumers and RMB 1,530 for rural consumers, accounting for 27 percent and 32 percent respectively of the total income for urban and rural residents. The average annual growth rate reached 11.8 percent for urban consumers and 11.5 percent in rural areas over the past five years. It is expected that food expenditures will keep rising quickly in the years to come.

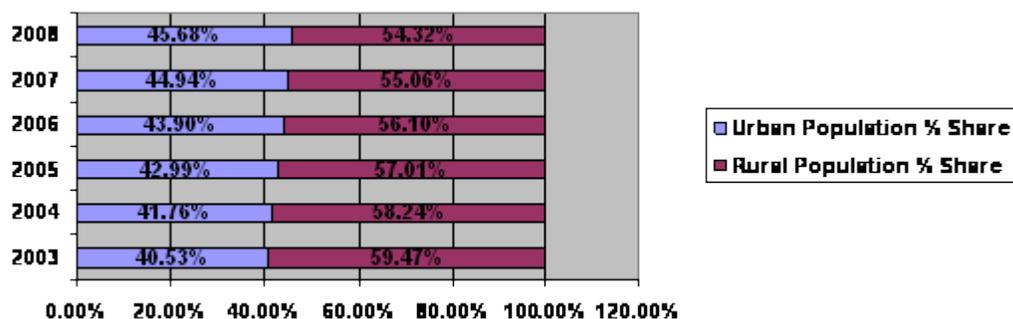
Continuing growth in disposable income is likely to lead to a middle-income consumer boom in urban areas. This group is starting to seek higher quality food and is a critical actor in the market for imported food products. The number of urban households earning more than US\$5,000 a year is estimated to grow by 24 percent annually, creating tens of millions of new consumers for high-value and imported food.

### Urbanization

The Chinese government has allowing urbanization for years, in a hope to generate more jobs for increasing surplus rural labors freed by modern agriculture and shrinking arable lands. As a result, rural population has been dropping as urban population climbs.

**Figure 6: Urbanization Trends 2003-2008 (Million)**

	2003	2004	2005	2006	2007	2008
<b>Total Population</b>	1292.27	1299.88	1307.56	1314.48	1321.29	1328.02
<b>Urban</b>	523.76	542.83	562.12	577.06	593.79	606.67
<b>Rural</b>	768.51	757.05	745.44	737.42	727.50	721.35



Source: China Statistical Yearbook, 2009

The figure above shows the clear trend toward urbanization. Over the past five years, the rural population has been contracted by 1.3 percent or by about 10 million a year while the urban population has been increasing by 3 percent or 15 to 20 million people a year.

With urbanization deepening, the traditional preference for fresh food from wet markets is giving way to processed food purchased from supermarkets. It is estimated the majority of Chinese will live in cities by 2013 - - and this will have profound implications for China's demand for processed foods.

### **Food safety**

Repeated food safety issues, particularly the Sanlu scandal in 2008, where contaminated infant formula milk powder led to three deaths and thousands of illnesses, are pushing up demand for safer food by consumers. A survey made by A.T. Kearney Inc in 2007 showed food safety is very important for the middle-class Chinese consumers, and that 83 percent consumers are willing to pay more for safer food. A more recent survey by the Horizon Group and Sohu News Centre also showed that food safety remains one of the biggest concerns for residents in China's major cities.

The Chinese government is focused on the food safety issue. The *Food Safety Law* has started to regulate the food processing industry from June 2009 while the government established a Food Safety Commission in February 2010. The Commission, which is led by a vice premier and includes 15 ministers of food related national agencies, will strive to clarify the roles of government agencies and strengthen cooperation between them. In China, safe food is often associated with imported food. Rising demand for high quality food ingredients, including U.S. food ingredients, is expected to increase as a result of these factors.

## **1.2 Consumer Trends**

Consumption patterns in China are in rapid transition, particularly in urban areas and in certain

populations. Some of these demographics and sectors include:

### 1.2.1 The young generation and convenience foods

As in most other countries, the generation aged from 20 to 40 is keen to use their increasing purchasing power to buy a better lifestyle. Unlike their parents, this age group is heavily influenced by western lifestyles. They are usually fond of dining out and shopping, and when eating at home, which is getting less frequent, they prefer cooked, semi prepared and packaged foods. For this group, frozen processed food is increasingly popular.

The quick frozen products industry has developed rapidly in China, thanks to the slowly improving cold chain infrastructure and rising refrigerator ownership. In urban areas, increased family income and busy middle-class schedules are driving residents to purchase frozen processed foods for convenience and the increasingly rich variety of products. In 2009, the Chinese government kicked off a campaign themed “Home Appliances to Rural Areas”. This provided a significant subsidy to people in rural areas who purchase home appliances - including refrigerators. More pervasive use of refrigeration has lead frozen products manufacturers to explore rural markets.

Due to differences in measurement and definition, estimates of the rate of growth of the frozen food industry vary widely. According to Euromonitor, total sales of frozen processed food (including frozen processed red meat, poultry, seafood, vegetables, potatoes, and quick frozen read-to-eat products) totaled to RMB 35 billion (\$5 billion) in 2009 - a 8 percent increase over 2008. However, according to Chinese food industry statistics, the increase exceeded 20 percent.

Some frozen food manufacturers faced lower margins in 2009 as unit prices decreased by around 2 percent as input costs increased. Price pressure on processed products was a result of consumers reducing their food expenses and manufacturer discounting. The cost of some key ingredients increased markedly. For example, the price of glutinous rice powder rose from RMB 2,600/MT in Feb 2009 to RMB 5,400/MT in Dec 2009, an increase of 108 percent.

**Figure 7: Best Performers of Major Categories of Frozen Foods in 2009**

Category	Products	Market Share in Its Category
<b>Frozen processed red meat</b>	Seasoned mutton bunch, seasoned beef, meat balls and sausage	N/A
<b>Frozen processed poultry</b>	Seasoned chicken wings	28%
<b>Frozen processed fish/seafood products</b>	Fish balls and shrimp balls	43%
<b>Other frozen processed products</b>	Dumplings, wontons and dim sum	59%

Source: Euromonitor

**Quick Frozen Processed Food:** The largest frozen processed food sector is quick frozen processed food products, which are increasing in variety. New types such as frozen pizza, frozen soup, frozen noodles and frozen desserts are gaining popularity among younger Chinese consumers. In the frozen processed red meat category, hotpot ingredients – seasoned mutton bunch, seasoned beef, meat balls and sausages emerged as stars thanks to the long winter and economic downturn in 2009. Many people choose to buy hotpot ingredients from supermarkets and cook at home.

Currently 90 percent of quick frozen processed food products are consumed by families via retail distribution. Distribution to the HRI sector is not well developed. However, higher margins in the food service sector are attracting some major players to opportunities in this area. Leading frozen foods manufacturers Syneer and Sanquan opened their own Chinese fast food chain restaurants “Yi Jiang Liang An” and “You Zhi You Wei” in 2005. However, both withdrew from these businesses in 2009, which illustrates the challenges of translating strength in processed foods into other sectors.

There were around 3,000 quick frozen processed food product manufacturers in China in 2009. Domestic brands dominated the frozen processed products market. Famous brands include Syneer, Sanquan, Longfeng, Haibawang, Taixiang, Jiayuan, and Haodangjia - mostly from north and central China. The top ten manufacturers held over 70 percent of total market share in 2008. Among them, the two biggest brands Syneer and Sanquan - both from Henan Province - took nearly 17 percent of the market.

Local firms have been trying to attract investment to expand rapidly. Some successfully export products to overseas markets such as Japan, Korea and even the United States. Both Syneer and Sanquan are publicly listed companies. In 2009, Sanquan opened a factory in Henan Province. The plant cost RMB 240 million and has an annual production capacity of 80,000 MT. Sanquan broke ground on a new plant in Chengdu in Dec 2009.

Encouraged by the prospects in this market, international food firms are entering China. General Mills produces frozen dumplings, wontons and noodles under the brand Wanchai Ferry, targeting the upper tier of the market. After years of effort, Wanchai Ferry has successfully positioned itself as a high-end brand in first tier cities. After the establishment of manufacturing plants in Shanghai and Guangzhou, Wanchai Ferry plans to build a plant in Beijing in 2010. Longfeng, another famous quick frozen food brand owned by Taiwan businesspeople, was formally acquired by Heinz in 2009 and reports that it has doubled its sales since then.

Post believes that the continuing urbanization and development of cold chain infrastructure presents immense opportunity for growth of the quick frozen food industry in China. At the same time, we expect fierce competition to continue driving industry consolidation.

### **1.2.2 Baby food keeps booming**

Approximately 20 million babies are born in China every year. Statistics show that around 80 million Chinese are under four years old. Chinese family planning policies allow most Chinese families to have only one child or face stiff fines. This ensures that more care and attention is lavished on the few children that families are allowed to have. A recent report by the China Social Science Academy revealed that an average 40-45 percent of household disposable income is spent on children in China.

According to Euromonitor, the size of the baby food market in China reached RMB 34 billion in 2009, an increase of 17 percent over 2008. In China, over 90 percent of mothers continue working outside the house. Working mothers are increasingly influencing the baby food industry, as they help maintain the income of the household at higher levels but have less time to prepare fresh food for their children. With increased disposable incomes, young Chinese couples are demanding safer and better quality baby foods, and are less sensitive to price. This is leading to strong growth in the baby food market. The spread of retail outlets, improved cold chain and distribution systems, and increased ownership of refrigerators are contributing to growing consumption of more diversified baby food products.

Spending per child is also on the rise, and consumers are able to afford higher quality and more expensive products. Unit prices of baby food increased in 2008 due to increasing global dairy ingredient prices as well as growing packaging materials and transportation costs.

Around 80 percent of the baby foods are distributed via supermarkets and hypermarkets and food stores in China. Due to quality and safety concerns with domestic brands, many parents turned to online shopping or purchasing via friends or relatives traveling abroad to purchase “100 percent foreign brand baby formula”.

Infant formula milk powder, dried baby food (such as rice powders), and prepared baby food (packaged foods in cans and jars), constitute the major baby food products.

**Figure 8: Market size of different sectors of baby foods, 2007-2009 (RMB million)**

Sectors	2007	2008	2009
<b>Infant Formula Milk Powder</b>	20,316.1	25,497.1	29,626.8
<b>Prepared Baby Food</b>	294.9	378.5	451.3
<b>Dried Baby Food</b>	2,628.9	3,260.9	3,869.7
<b>Total</b>	23,239.9	29,136.5	33,947.7

*Source: Euromonitor*

Infant formula milk powder represented 87.3 percent of the infant food market in 2009 and is its fastest growing sector. The top five international brands - International Nutrition (Dumex), Mead Johnson (Enfagrow, Enfapro, Enfachild, Enfaschool), Abbott Nutrition International (Gain, Similac), Nestle (Lactogen, Neslac), and Wyeth (Promise, S-26, Bright Promil) - took over half of the market. Beingmate overtook Yili from Inner Mongolia, Shengyuan from Qingdao, Yashili from Guangdong, and Wonder Sun from Heilongjiang to become the star performers among domestic brands. Not implicated in the melamine scandal in 2008, the Hangzhou-headquartered Beingmate saw a significant increase in its sales and consumer awareness. It produces baby food

in all three categories - infant formula milk powder, prepared baby food and dried baby food – and has more than 200 products in its portfolio. In 2009, Beingmate’s sales revenue exceeded RMB 10 billion (\$1.5 billion), and the firm is planning a stock market listing in 2010.

Post estimates that in 2010 the value of baby food sales will continue to grow because of price increases and the rising birth rate. The baby food market is not as price sensitive as other markets, especially in affluent areas like Yangtze River Delta, where consumers are more inclined to buy foreign brands. Quality and safety remain the key factors influencing purchasing decisions.

Competition in this sector will become even fiercer in 2010. Many firms are striving to increase their market share with intensive promotion and PR campaigns designed to restore consumer confidence. This is especially true of domestic baby formula brands that were not implicated in the melamine scandal, including Beingmate from Hangzhou and Feihe from Heilongjiang, and those who strengthened quality control, including Yili from Inner Mongolia.

### 1.2.3 “Gray hair” food rising

While the younger market gets the most attention, there are many emerging opportunities at the other end of the age spectrum. Since China is aging rapidly, this is creating a new food sector, the so-called “Yinfa” sector, or “Gray Hair” industry.

**Figure 9: Population by Age 1995, 2007 and 2015 (% of total Population)**

Age Groups	1995	2007	2015
0-4 yrs	8.23	4.82	5.08
5-9 yrs	10.18	5.59	4.92
10-14 yrs	8.60	7.12	4.95
15-19 yrs	8.06	9.02	5.91
20-24 yrs	9.89	6.56	7.25
25-29 yrs	10.32	6.56	8.06
30-34 yrs	8.06	8.29	6.52
35-39 yrs	7.20	9.81	6.84
40-44 yrs	6.88	9.74	9.10
45-49 yrs	4.93	6.31	9.64
50-54 yrs	4.13	7.53	7.95
55-59 yrs	3.78	5.61	6.82
60-64 yrs	3.40	4.05	6.32
65-69 yrs	2.60	3.28	4.14
70-74 yrs	1.86	2.73	2.79
75-79 yrs	1.08	1.68	1.94
80+ yrs	0.82	1.28	1.74
<b>TOTAL</b>	100.00	100.00	100.00

*National Statistics, UN, Euromonitor International  
As of 1 January 2008*

The table above shows that the population over the age of 60 has increased from 9.76 percent in 1995 to 13.02 percent in 2007 – and is estimated to reach 16.93 percent by 2015. Two important forces jointly make this happen: one is the increasing life expectancies, which has brought the number of elderly up to 170 million by 2007, and will be up to over 230 million by 2015 in a projection. The other force is the One Child Policy, which works in the opposite way by decreasing the size and proportion of children in the population.

The ever growing number of the old has fueled the emerging Gray Hair Industry, of which food is an important component. The old pay extra attention to food, believing in the old saying “Shi Bu Sheng Yu Yao Bu”, meaning “healthy food is superior to medicine”. They strive to have a balanced diet, consisting of grains, wheat, beans, meats, fish, vegetables, and fruits. In addition, they are interested in functional foods, vitamins, or nutritional supplements. The young also tend to buy their parents various nutritious foods to fulfill their filial duty. There is reason to believe food manufactured for the old that is safe, high quality, easy to eat, and nutritious will have a bright future in China.

#### **1.2.4 Dairy foods**

The Chinese dairy industry has been recovering briskly from the 2008 melamine scandal and has entered a period of high growth. According to industry statistics, total dairy sales in China reached RMB 165 billion (USD 24 billion) in 2009, a 12.4 percent increase from 2008. Total volume amounted to 19.4 million metric tons, an increase of 12.9 percent over 2008. Fluid milk production hit 16.4 million metric tons, an increase of 13.5 percent, and milk powder production reached 1.1 million metric tons, and increase of 11 percent over 2008.

Per capita annual consumption of dairy products in China’s urban areas is around 29 kg, but is much lower in rural areas. This urban-rural gap partially explains the large gap between China’s rate of consumption and the average per capita consumption rates of 268 kg in developed countries.

Chinese import statistics revealed that China’s import of dairy products increased sharply in 2009, reaching 600,000 metric tons, 70.2 percent higher than 2008. However, the total value of imports only grew 19.3 percent, hitting \$ 1 billion. Milk powder was the biggest import item in 2009. Import volume increased 144 percent, but import value only increased 45.8 percent. An emerging star is imported fluid milk, with volume reaching 12,779.4 metric tons, an increase of 72 percent over 2008.

China only exported 36,780 metric tons of dairy products in 2009, a drop of 69.5 percent in volume terms and 81 percent in value terms. Milk powder exports decreased by 84.7 percent, condensed milk exports dropped by 54.2 percent, and cheese exports fell by 70.6 percent in value. This decrease reflected the lack of confidence in Chinese dairy products in the global market. China still has a long way to go to get out of the shadow cast by the melamine scandal.

**Figure 10: Retail Value of Dairy Markets (million \$)**

	2005	2006	2007	2008	2009
Dairy Products	14,725.3	17,461.8	20,173.7	21,069.6	21,419
Drinking milk products	12,284.4	14,442	16,546.5	17,087.5	17,055.9
Cheese	59	69.8	82	98	114.2
Yoghurt & sour milk drinks	2,221.6	2,779.9	3,364	3,691.1	4,043.9
Other dairy products	160.3	170	181.2	193	205

*Source: Euromonitor*

Fluid milk has been the fastest-growing segment over the past five years because it has become a staple of the middle class' daily diet. For manufacturers, the fluid milk market has a lower price entry point compared with other dairy products, which have higher processing requirements. There are currently more than 2,000 companies in China involved in fluid milk manufacturing. UHT milk has greatly improved the availability of fluid milk for consumers in urban areas, and it has quickly come to the fore and gained a larger market share during the past five years. At the national level, UHT milk has about 80 percent of the market, but in big cities such as Shanghai, pasteurized milk occupies more than 70 percent of the market.

Continuing its robust growth in 2009, cheese is the undisputable star in China's dairy market. Although it is not traditionally part of the Chinese diet, the small cheese market has great growth potential. Consumption is being boosted by the idea that cheese is a good source of protein and calcium for supposedly lactose-intolerant Asian people. From 2004 to 2009, China topped all emerging markets with total volume sales growth of 130 percent. According to Euromonitor, the retail value of cheese sales grew by 17 percent in 2009 to \$114.2 million. Bright Dairy leads cheese sales with around 50 percent of the market share, and Anchor, the New Zealand brand, and Pikoufu, a French brand tailored to Chinese tastes, rank No.2 and No.3 respectively in the cheese sector. The top three brands occupy over 60 percent of the market share.

Around 80 percent of dairy products go to consumers via retailers, who have experienced significant consolidation during the past five years. Supermarkets/ hypermarkets have been evolving into major outlets for all varieties of dairy products. For cheese products, yogurt, and take-home ice cream, the supermarkets' role is even more important. This is due to consumer's confidence in their relatively better-developed cold chain facilities. The improved availability of supermarkets and convenience stores in rural areas also contribute to their increasing share of distribution.

Yili, Mengniu and Bright Dairy are the top three manufacturers in terms of annual output. They collectively control more than 50 percent of the national market. Mengniu has the highest market share in fluid milk, while Bright Dairy ranks No. 1 in yoghurt and cheese. Yili is more focused on milk powder production, and its ice cream sales increased very rapidly in recent years.

Unfortunately, melamine problems continue to crop up. Most recently, in December 2009, there have been several melamine contamination cases that resulted from the mishandling of seized melamine contaminated milk

powder in 2008. These cases hit consumer confidence and damaged the reputation of China's dairy industry, which is still reeling from the 2008 problems. It is said that Shanghai Panda Dairy Company - who was caught reusing melamine-tainted condensed milk - was closed and its business license was revoked. Post forecasts that these cases, together with fierce competition, will facilitate industry consolidation, with more small brands disappearing. However, competition among the three giants will not change much. Imported dairy products will enjoy a larger group of loyal consumers, with more brands taking market share in first tier Chinese cities.

### **1.2.5 Bakery ingredients**

Over the last ten years, China's baking sector has grown by 10 percent annually. This trend is surprising given China is traditionally not a bakery food consuming market. Demand is mostly driven by strong economic growth, increasing disposable incomes and globalization that is changing consumption patterns. Western lifestyles in urban areas are the main drivers behind the increase in packaged/industrial bread in China. Young families and white collar workers are also an important bread consuming segment of the China market.

The recent global financial crisis had a minimal impact on China's fast growing bakery industry. In fact, Mr. Zhu Nianlin, Director of the China Baked Foods Association during an media interview mentioned that China's baking industry had reach an annual growth rate of 20 percent in the past few years. To illustrate current emerging trends, this section looks at South China, which also boasts China's most developed baking industry.

South China's affluent bakery industry is thriving in major cities in Guangdong (Guangzhou and Shenzhen) and Fujian (Fuzhou and Xiamen) provinces. Increasing income levels have led to faster paced lifestyles that demand ready-to-eat and prepared foods. Western style baked items, including breads, cakes, pastries and desserts, have all become popular daily meal items—not just snacks.

The growth in the bakery sector has attracted both foreign and domestic operators. While veteran chain stores like *Maxim's Group* and *Queens Cake Shops* in Guangdong, enjoy consumer loyalty thanks to their consistently high product quality; upscale newcomers such as Bread Talk and Yamazaki, coffee shops, convenient stores, and supermarkets are trying to increase their market share by introducing innovative flavors, interesting product names, comfortable sitting areas, and eye-catching store layouts.

The bakery industry is highly fragmented because it requires time to develop a well-known brand and a high quality production. Uneven development of the industry, subtle consumer taste differences, and regionalized bakery chains also contribute to the bakery industry's fragmentation.

Bakeries using imported ingredients mostly market to higher-end consumers; and because South China consumers frequently substitute bakery products for meals, protein content, ingredients, price, and value are especially important factors.

South China's baking industry relies on domestic and international ingredients suppliers and traders in Mainland

China as well as in Hong Kong. Bakeries are categorized as industrial manufacturers, bakery chains, retail outlets, and high-end hotels. The bakery industry in Guangdong and Fujian provinces is much more developed than other southern provinces.

A limited number of ingredients traders serve most of the market. Traders typically consolidate ingredients from a number of other brokers and then market them to bakeries. Many of these traders supply a full range of ingredients, whereas some specialize in a certain category of ingredients, such as, dairy ingredients, oils, etc. With marketing support from ingredients producers, major ingredients traders can provide technical assistance to clients.

South China's bakery industry trends at-a-glance:

- Bakery chains are capturing larger market shares from individual bakery shops as bakery chain brands aggressively market to consumers;
- Bakeries must establish and maintain a cold chain in order to deliver freshness to their consumers. For example, frozen dough is commonly sourced to smaller outlets delivered in refrigerated vehicles.
- Operations have become increasingly standardized and less labor intensive, because of the increasing labor costs

South China's bakery industry relies on high quality U.S. bakery ingredients. Bakery products made of high quality ingredients is how high-end bakeries differentiate themselves from competitors. This trend has contributed to increasing sales for U.S. bakery ingredients in South China. A wide range of imported baking ingredients, including wheat flour, dairy ingredients, dried fruit and nuts, fruit jam, filling and premixed flour, are frequently incorporated in baked goods by high-end bakeries aiming to enhance nutrition and improve product appearance. By importing high-quality U.S. bakery ingredients, South China bakeries are successfully adding value to their bakery products and receiving higher returns from sales.

Large international baking ingredients makers, including *Rich's*, *Bake Mark*, *AB Mauri* and *Roquette* aggressively promote their products in this market. Some international giants have also established processing plants in China to better serve this region. Bakery associations from the United States, France, Germany, and Japan are also actively developing their networks in the Chinese industry. The United States is a competitive supplier of bakery ingredients because its products enjoy a reputation for high quality, readily availability and a diverse product mix.

Traders tend to categorize ingredients into three groups:

- (1) Large volumes of frequently used ingredients such as flour, sugar, fat and oil
- (2) Items used less frequently but that add value to the final product, such as canned fruit, baking powder, and chocolate
- (3) Additives and colorings.

Below is a summary of opportunities and constraints for U.S. ingredients in South China.

Opportunities:

- Booming bakery industry is generating ample opportunities for high quality baking ingredients;
- Wealthy consumers in the region and a increasingly westernized life style generate substantial demand for high quality baked products;
- A falling U.S. dollar relative to the Chinese Renminbi makes U.S. ingredients more price competitive in this price sensitive market;
- As consumers are exposed to more western baked goods in their travels to other Asian countries and to North America and Europe, they are looking for similar items locally.

Constraints:

- Limited knowledge by baking professionals on the use and application of U.S. baking ingredients, and how these can add value to their sales;
- Lack of new recipes featuring U.S. ingredients because of the perception that products made with U.S. ingredients are too expensive;
- Low consumer awareness of the wide variety of U.S. bakery ingredients and their benefits.

Price is a determinant factor for bakery ingredient sales. Chinese ingredients are usually less expensive, and produced by numerous small farms; therefore these tend to lack desired consistency. Compared to Chinese ingredients, U.S. ingredients are produced on a larger scale with more stringent standards. This enables more consistent quality, traceability and guaranteed food safety. However, prices are highly sensitive and constrain expansion of U.S. ingredients in this market. Some imported ingredients, for example, cheese, butter, whipping cream, high quality fruit jam, high quality dried fruit and nuts are more popular among upscale bakeries.

Successful ingredients promotions have worked closely with ingredient traders and on user while promoting final product sales to consumers. Main targets for ingredient promotion should include bakery manufacturers, bakery chains and luxury hotels with internal bakeries. South China cities include Guangzhou, Shenzhen, Dongguan and Foshan in Guangdong province, as well as Fuzhou and Xiamen in Fujian province, where the baking industries are well positioned to feature U.S. ingredients as a way to add value to their bakery products and increase sales and their bakery's reputation.

High quality and health benefits are the strong selling points for U.S. ingredients in the China market. A number of helpful suggestions to spur consumption of U.S. ingredients in the market include:

1. Educate both bakers and consumers on the product (food ingredients);
2. Provide technical assistance to bakeries;
3. Work with Chinese bakers to develop recipes that suit the local palette and market;

#### 4. Conduct in-store promotions to encourage purchases

### 1.2.6 Tree nut snacks and dried fruit ingredients

Nut snacks sales in China reflect consumer preferences that vary by region and from nut to nut. In general, flavored nut snacks remain popular items, while natural tastes are more popular among middle and upper income niches where consumers tend to consider natural tastes as a healthier and safer choice. In general, people in south and east regions of China prefer sweetness, while north and northeastern consumers prefer saltiness. To accommodate this, nut processors adjust the percentage of salt and sugar when flavoring nut snacks. However, flavor preference for pistachios seems universal across the country where they are dunked in a sugar and salt brine, then roasted to remove the moisture. As for pecans, butter-flavored is preferred in the east while spiced flavor is more popular in the rest of China. Hazel nuts are only generally roasted with no flavor or condiment is typically added.

#### **Pistachios**

Non-bleached U.S. pistachios are gaining ground over previously dominant bleached ones in China. Compared to U.S. pistachios, Iranian productions are usually cheaper and have a darker shell color. To meet consumer preferences, Iranian pistachios are normally bleached prior to selling and have dominated the China market for years because of lower prices. In addition, most Chinese consumers wrongly equated whiter colored shells with better quality. U.S. pistachios, with natural ivory color, re-entered the China market in 2007 with a strategy to differentiate themselves from their Iranian competitor by promoting non-bleached natural ivory shell color. Meanwhile, U.S. exporters also educated Chinese consumers about the health benefits of non-bleached products over bleached ones. These efforts have paid off. According to the trade, non-bleached products only held a 10-percent market share in 2007, but quickly climbed to 30-40 percent in 2008. Local sources anticipate greater market share for non-bleached pistachios in coming years. Non-bleached pistachios are mostly sold to middle and upper markets, while bleached ones are sold in lower end markets.

#### **Pecans**

80 percent of total pecans are produced in the United States and are used mostly in-shell for snacks, plus some shelled as ingredients for baked products, ice cream and candies. Mexico and Australia enjoy good reputation for product quality and hold 15 and 8 percent of the market share respectively in China (mostly in-shell). China started a small production of pecans, but it will take another four to five years until the crops mature.

Up to seven U.S. varieties are marketed in China. The most popular is Western Schley, due to its large size. Chinese processors and traders often buy pecans directly from U.S. growers to minimize costs. Shelled pecans have limited share in the China market, and are mostly used to make prestigious food items such as

*Haagen Daz* ice-cream and bakery items sold in *Starbucks* coffee outlets.

**Hazelnuts**

Recently, traders have lost interest in hazelnuts due to shrinking profit margins and diminishing returns. Importers in Hong Kong used to sell to large nut traders in Mainland China who in turn sold to smaller processors. Hong Kong traders then bypassed the large nut traders and sold directly to the small Mainland China processors and wholesalers. This created an environment with intense competition among traders in the two regions, profit margins were squeezed to such low levels that most traders, especially large ones, lost interest in carrying the nut.

**Raisins**

Most imports come from the United States, followed by Turkey. Imports enter Qingdao and Tianjin ports in northern China for repackaging and re-export to other Asian countries including Japan and Korea. Imports through Shanghai and South China are mostly for domestic consumption for snacks and ingredients. Less expensive Chinese raisins from Xinjiang Province dominate the lower end market where prices are highly sensitive. U.S. raisins in recent years have gained small but increasing market shares in high-end niches, especially luxury hotels and high-end bakeries, as users in these sectors learn the value that U.S. raisins can bring to their products. In addition, the annual bread baking contests organized by the Raisin Administrative Committee (RAC) have helped educate Chinese bakers in maximizing the advantages of using American raisins.

**Blueberries and Cranberries**

Not until recently did blueberries and cranberries enter the China market. China does not grow cranberries, and has a small crop of blueberries in Liaoning and Shandong Province. Both fruits have gradually gained awareness in the food industry as bakery ingredients. Many affluent consumers, especially those in large cities, have heard of blueberries, but the awareness of cranberries is limited. Blueberry jam or filling, dried blueberries are often used in western style baked items and pastries in upscale bakery shops, whereas in lower end market, blueberry flavors are used instead of real blueberries as a cheap substitute. Most cranberries are dried and used in such items as muffin and bread. They are also sometimes used to make the cranberry-red wine moon cake filling. There is largely untapped potential for both fruits in both primary and secondary cities.

**1.4 Advantages and Challenges**

Below is a list of advantages and disadvantages faced by U.S. suppliers in China.

Advantages	Challenges
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China is the world's largest food market and also a large processor of many food categories that supply both domestic and export markets.	Fragmented markets in a geographically large nation with underdeveloped logistics and infrastructure as well as cold chain system.
Upscale food makers eagerly look for high quality ingredients that add value to their products, and leading food makers are more likely to use imported ingredients to develop new products.	Food processing, retail and HRI sector as well as distribution channels in less developed areas lag far behind those in the affluent coastal region, hampering further penetration.
Increasing concerns about food safety and health creates more opportunities for high quality ingredients	Incomplete Chinese standards and discrepancies between Chinese and U.S. standards may create technical barriers to trade.
A large number of emerging city markets offer tremendous opportunities for further growth.	Increased access for imports has resulted in greater competition from other exporting countries. TBT and SPS issues impact trade.
The potential appreciation of Chinese RMB would make U.S. products more competitive in this price sensitive market.	Increasing commodity prices and logistics costs offset depreciation of the U.S. dollar.
A cost advantage makes China a good base for value-added processing.	Logistics and distribution channels in newly developed area still lag.
Fast development of ports in various parts of China provides more entries for products entering China	Infringement of intellectual property rights remains a serious concern in China.
Major international events including 2010 World Expo in Shanghai and 2010 Asia Games in Guangzhou provide ample opportunities to promote food products.	Chinese consumers are price-sensitive: imported products have difficulty competing with domestic substitutes on price alone.
Urbanization and changes in living styles favor consumption of more processed food.	Basic agricultural production is not well integrated with the commercial food processing sector.
High-income earners favor products that can improve their quality of life, and are willing to pay a higher price.	Imports are regarded as expensive. Price-sensitive consumers are less willing to buy imported products without knowing their value.
Imported goods and raw materials from the U.S. are generally regarded as high in quality.	Frictions between China and the U.S. affect trade negatively.
Various age groups, such as baby group and the old group, are in higher demand on safer and healthier food than ever.	
Effectiveness of the Food Safety Law and establishment of the State Food Safety Commission will create a friendlier environment for the food processing industry.	

## 1.5 Regional Development

China's food processing industry is concentrated in the country's most developed affluent regions along the coast, with Beijing, Shanghai and Guangdong being the major centers. Southwest China, which hosts Chengdu and Chongqing, two of the top emerging city markets in China, is also developing rapidly in food industry. To capture the diversity of the countries food processing industry it is easier to divide China into four regions, South China, East China, North China, and Southwest China.

### 1.5.1 South China

Thanks to a more developed market economy than in the rest of China, South China's food processing companies dominate the market. The most developed provinces in South China are Guangdong, followed by Fujian, then Hunan, Guangxi, and Hainan. Processors in Guangdong and Fujian cover all lines of food products, drinks, and snacks. Guangxi and Hainan produce traditional food and drink and their product sales largely remain in the respective provinces, with an exception of the coconut juice from Hainan which has benefited from a strong national media campaign. In contrast, some products from Hunan sometimes appear on shelves outside of the province, but in general, Hunan processed foods are not well-known throughout in China.

Similar product lines, marketing campaigns, management systems, business models, pricing, distributing and channeling are found through out the industry. Because of low entry barriers and little product differentiation, industry consolidation is necessary.

**Figure 11: Food Processing Industry in South China by Province 2008\***

Provinces	Categories	Number of Enterprises	Gross output value** (million US\$)
Guangdong	Food Processors	911	14,758.6
	Food Manufacturers	788	7,793.4
	Beverage Manufacturers	244	5,672.4
	<b>Total</b>	<b>1,943</b>	<b>28,224.4</b>
Fujian	Food Processors	8,482	7,330.3
	Food Manufacturers	5,455	3,417.5
	Beverage Manufacturers	8,263	2,302.6
	<b>Total</b>	<b>22,200</b>	<b>13,050.4</b>
Hunan	Food Processors	734	6,469.5
	Food Manufacturers	288	2,690.9
	Beverage Manufacturers	213	1,311.7
	<b>Total</b>	<b>1,235</b>	<b>10,472.1</b>
Guangxi	Food Processors	454	7,826.2
	Food Manufacturers	139	580.9
	Beverage Manufacturers	123	1,230.6
	<b>Total</b>	<b>716</b>	<b>9,637.7</b>
Hainan	Food Processors	86	818.0
	Food Manufacturers	27	271.4
	Beverage Manufacturers	21	309.6
	<b>Total</b>	<b>134</b>	<b>1,399.0</b>
<b>Regional Total</b>		<b>26,228</b>	<b>62,783.6</b>

Sources: *Statistical Year Books 2009 of reported provinces*

*\*Latest available data, including only those enterprises that realized annual sales over US\$ 657,895 (RMB 5 million) in CY2008*

## **Fujian**

A coastal province with roasted eel as its largest processed food export, Fujian was the cradle of several established national brands, such as Dali, Yake, Fuma, Qinqin and Panpan. Traditionally, Fujian was known for producing preserved dried fruits and crispy skin peanuts. Now the province supplies the country with a full selection of beverages, confectioneries, packaged baked products, potato chips, shrimp chips, cookies, crackers, frozen vegetables, canned food and snacks. In the past twenty years, intense competition has prompted companies to invest in brand development. All major Fujian processed food industry leaders invest in TV advertisement and have celebrity spokespeople. For example, Dali, a beverage manufacturer hired three celebrities to promote its herbal tea, honey green tea, yogurt and protein. Yake used a famous actress to market its V9 candies on China's Central TV channels. Singers from Taiwan promoted packaged pies for Fuma and chips for Qinqin. Panpan successfully associated their snacks with the Chinese space ship, won a title of "designated food for aviators". Qinqin now manufactures Pringles Chips for Procter and Gamble.

## **Hainan**

This tropical island is well-known for producing vegetables and fruits. Processed products include canned pineapple, fruit in syrup, coconut candies and canned coconut juice. The food processing industry is growing and specialty snacks using local ingredients are becoming popular in South China. Hainan produces a large volume of bananas, pineapples, lichee, dragon fruit, coconuts, and vegetables, juices and vegetable drinks, however farmers have encountered transportation and logistical problems when marketing their products outside of the island.

## **Hunan**

The province is located to the north of Guangdong and is known for its traditional spicy food. It was a traditional agricultural province, supplies Guangdong and other provinces rice, pork, hogs, and vegetables. Although the province houses over a thousand food processors, only a handful of them are large enterprises and none of them have established a national brand. Hunan's total output for processed food was up 42 percent in 2008, but it centered on "basic needs" products such as condiments, meat items, oil, rice, liquor, fruit and vegetable. Advanced food processing technology is limited, even though the province vows to achieve \$88 billion in food processing by 2015.

## **Guangxi**

An agricultural province, Guangxi is best known for its sugar cane production. Its processed foods are seldom marketed to other parts of the country. Guangxi traditional rice noodle and chilly paste are the two main categories for processed food. Many small food processing plants contribute to the province's food sales, but their development lags behind other players in South China.

## **Guangdong**

Guangdong was the first province to move out of the planned economy into a market-based model. As a result, it leads not only in trading but also in food processing. All lines of products and business models can be found in Guangdong. In addition to the large number of local food enterprises, foreign companies also operate in the province. *Nestle* coffee and *Heinz* baby food are the two early market entrants. Bordering Hong Kong and Macau, Guangdong consumers have enjoyed many new products and flavors well before other consumers in Mainland China. In the 19<sup>th</sup> century, bakery was first introduced to China in Guangdong by businessmen from Hong Kong. Advanced food processing technology migrated later on with Taiwan, Hong Kong, and Macau investment. Unlike their counterparts in Fujian, food processors in Guangdong do not use television advertisements to promote their products. Instead, they differentiate themselves by emphasizing food safety, taste, quality, packaging, display, and services. Because of strict internal controls, Guangdong dairy businesses were not severely impacted after the melamine scandal in 2008. Functional drinks, health foods and supplements are in greater demand because consumers in this market are more health conscious than consumers in other provinces. Many educated consumers require food or drink contain less chemicals and additives. Both the processors and consumers in the province have been exposed to imported ingredient for many years, allowing high end food items great market potential. Guangdong Province is where American food ingredients exporters have made the deepest inroads.

### **1.5.2. East China**

With a population totaling 120 million and an advantageous geographical position, the Yangtze River Delta boasts one of the most vibrant regional economies in China. Its geographic scope includes Shanghai, Zhejiang and Jiangsu provinces, all ranked among the top 10 regions in terms of economic strength. Occupying only 2.1 percent of China's land area, and accounting for only 11 percent of the total population, the region accounted for more than 21.4 percent (\$1,052 billion) of China's gross domestic product (GDP) in 2009. The average GDP growth rate of the Yangtze River Delta was 9.8 percent, higher than the national GDP growth rate of 8.7 percent. The 16 cities in the region absorbed over 35 percent of foreign direct investment (FDI) in China over the past ten years. In 2009, an estimated 30 percent of newly invested foreign capital went to Jiangsu Province alone.

The food processing industry is an important part of the Yangtze River Delta Economic Zone's (YRDEZ) economy. The region's affluence, high population density, sound infrastructure, and easy access to seaports all contribute to the prosperity of the sector. The strength of the food processing industry in the YRDEZ is in dairy

products, meat products, seafood products, snack foods, instant noodles and drinks & beverages.

The numerous food processors in Shanghai, Nanjing (Jiangsu Province), Kunshan (Jiangsu Province), Suzhou (Jiangsu Province) and Hangzhou (Zhejiang Province) have built a strong reputation in eastern China. They have created many famous brands of packaged food and beverage products.

“Made in Shanghai” has become a quality guarantee for Chinese consumers when they choose processed food products and beverages. Bright Food Group is the biggest food processor and distributor in Shanghai. Its sales revenue reached \$ 7.5 billion in 2009 and is expected to reach \$ 8.5 billion in 2010. It owns 8 nationally famous brands and over 30 regional brands focused on Shanghai. These include Bright Dairy for dairy products, Big White Rabbit for candy, Zheng Guang He for drinks and beverages, Ai Sen for processed meat products, Meilin for canned food products, Guan Sheng Yuan for honey products, and Gold Maple and Shi Ku Men for rice wines. Ten of Bright Food Group’s branch companies are official sponsors of the 2010 World Expo in Shanghai. Bright Food Group already represents many famous food & wine foreign brands in China and is aggressively acquiring enterprises in other countries. In 2009, Bright Food Group acquired the biggest sugar producer in Australia. In early 2010, it formed a strategic partnership with General Nutrition Center (GNC), the largest global specialty retailer of nutritional products, to jointly explore China's huge nutritional supplement market. Bright Food has also expressed a strong interest in acquiring wine and dairy business in other markets. In January 2010, Bright Dairy bid \$1.4 billion in cash for Australia-based CSR’s sugar unit.

Headquartered in Hangzhou, the largest city in Zhejiang, Zhong Cui Foods is a strategic global partner of Coca-Cola. It is also the first Coca-Cola bottler in China and focuses on soft drinks. Its sales reached \$ 337 million in 2008. The largest domestic beverage brand, “Wahaha”, was also created in Hangzhou. Ningbo, another city in Zhejiang, benefits from its coastal location and produces several kinds of processed seafood that are widely distributed throughout China.

Jiangsu Province is very strong in meat products and snack foods processing. Yu Run Group, China’s biggest processed meat product manufacturer, is headquartered in Nanjing, the capital city of Jiangsu. A private company that started with meat processing in 1993, Yurun has grown into one of China’s Top 500 enterprises, with 2009 sales hitting RMB 45 billion (\$ 6.6 billion). In recent years, Yurun Group has increased investment in logistics and supply chain integration, and has set up several agricultural products trading centers in various parts of China. A new center being built by Yurun in Nanjing will cost RMB 11 billion (\$ 1.6 billion). Suzhou is the economic capital of Jiangsu Province. It had the fifth highest GDP in China in 2009, after the 1st tier city group Shanghai, Beijing, Guangzhou and Shenzhen. It ranks second in China in foreign investment attracted, just after Shanghai. Suzhou has attracted large investments by foreign food manufacturers including Nabisco and Rich Products from U.S., Pokka Four Seas from Japan, Loyal Food Industrial from Canada, President Instant Noodles from Taiwan, and Po Li Foods from Panama.

In 2008, the output value of the preliminary processors of agricultural products dropped by 5 percent, while the

gross output value of manufacturers of more in-depth processed foods increased by 26 percent over the previous year. The numbers of food & beverage manufacturers are rather stable from 2007 to 2008. This status reflects that the food processing industry in the YRDEZ has been addressing the rising labor and environmental costs successfully. While new enterprises are still being created to tap this vigorous market, some smaller manufacturers are moving out of the region to make ends meet.

**Figure 12: Food Processing Industry in YRDEZ by City and Province 2008:**

Cities and Provinces	Number of Food Processors	Gross output value (1 billion RMB)	Number of Food Manufacturers	Gross output value (1 billion RMB)	Number of Beverage Manufacturers	Gross output value (1 billion RMB)
Shanghai	170	20.8	259	28.9	60	13.4
Jiangsu	1,221	46.2	328	23.8	220	21.7
Zhejiang	N/A	52.2	N/A	20.6	N/A	24.5
<b>Total</b>	<b>N/A</b>	<b>119.2</b>	<b>N/A</b>	<b>73.3</b>	<b>N/A</b>	<b>59.6</b>

Source: Shanghai and Jiangsu Statistical Year Book 2008 and Zhejiang government report.

Note: the “food processors” in the Chinese yearbook refers to preliminary processing agricultural products into food, and “food manufacturers” refers to more in-depth processed food manufacturing.

Most shelf-stable processed food products and beverages are distributed through hypermarkets/supermarkets and convenience stores in east China. The major international retail giants have all entered this area, and almost every city in Yangtze River Delta has one or more of their outlets. Many of the largest retailers, indicated in the following chart, are active in the region.

**Figure 13: Leading Food Retailers in China: 2008**

Company	Ownership	Business Line	Stores	Sales* ¥ billion
<b>Chinese</b>				
Lianhua	China SOE**	Super/Hypermarket/ Convenience	3932	74.0
Wumart	China Pvt	Supermarket/ Convenience	726	31.0
Suguo (CRV)	China SOE***	Supermarket/ Convenience	1802	45.0
Nonggongshang	China SOE	Super/Hypermarket/ Convenience	3330	39.0
Vanguard (CRV)	China SOE	Super/Hypermarket/ Convenience	2698	49.1
Xiuyijia (A. Best)	China Pvt	Department	105	25.0
Wuhan Zhongbai	China SOE	Super/Hypermarket	626	16.0
<b>Multinational</b>				
RT Mart	Taiwan	Hypermarket	101	49.4
Carrefour	France	Hypermarket	134	49.7

Wal-Mart	U.S. JV	Hypermarket	123	41.0
Metro	Germany JV	Hypermarket	38	18.5
Tesco	U.K. JV	Hypermarket	61	19.9
Auchan	France	Hypermarket	31	11.9
Lotus	Thailand	Hypermarket/Convenience	76	19.1

\* Food and non-food sales

\*\* SOE= State-Owned Enterprise

\*\*\* Joint venture with China Resources Vanguard

*Source: China Chain Store & Franchise Association 2008*

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*Source: GAIN Report CH 0801*

Shanghainese spend over one third of their disposable income on food annually. A growing percentage of that amount is spent on imported products and products with imported ingredients, such as dairy products, snack foods, tree nut products and confectionary items. Affluent consumers in the Yangtze River Delta are willing to pay premium prices for branded products with more variety and higher quality, and they are receptive to new flavors from overseas.

Higher incomes are allowing east China consumers to become more lifestyle-focused, and the quickening pace of life is increasing acceptance of ready-to-eat and prepared foods - including bakery foods and processed frozen foods. Meanwhile, the continuing process of urbanization and the increasing influence of Western cuisine culture is driving demand for convenient, healthy, low-fat and fortified food products. Major events include the 2010 World Expo in Shanghai that will create additional growth opportunities for both HRI and retail players.

### **1.5.3. North China**

North China is home to 15 provinces, special municipalities and autonomous regions. The region covers about half of the land size of China, spreading from the east tip facing the Pacific Ocean in Shandong to Xinjiang, the geographical center of the Asian continent. The provinces within the region vary so much geographically, socially, economically and culturally, that it is too hard to talk about them as a whole.

The food processing industry is clustered in the east part of the region, namely, Shandong, Hebei, Henan, and Inner Mongolia, and the strengths include meat processing, seafood processing, beer, dairy products, and instant noodles.

#### **Meat processing**

Meat processing is a major industry of the region. Henan is the largest meat processing province in China. It is estimated that five out of 10 of packages of ham sausages produced in China are made in Henan Province alone. Henan Shineway Group (Shuanghui), the largest meat processor in China, has also been the champion of China's top 100 food processors since 2005. Jinluo, located in Shandong province, is also a major player of meat processing in China.

### **Frozen food**

Henan is also the largest frozen food producing province in China and is home to a number of major frozen food manufacturers, including the well-known brands such as Sinian, Sanquan, Kedi and Zhongpin. Major products include frozen dumpling, frozen tangyuan, and frozen baozi (dumplings).

### **Instant noodle and flour products**

Henan and Hebei are two of the major instant noodle producing provinces in China. Baixiang and Nanjiecun of Henan, Hualong of Hebei are some of the top producers of instant noodles and noodle foods.

### **Seafood**

Seafood processing is one of North China's major food processing industries and is mostly concentrated along the coastal cities of the Bohai and Yellow Seas, especially in Shandong and Liaoning provinces. The majority of imported seafood products is processed in these areas then re-exported to the United States, Japan and the EU.

### **Beer**

Beer production is among the most significant processing industries in the region. Tsingdao and Yanjing, the second and third largest beer brands in China, are both located in the region. Shandong province, the home province of Tsingdao beer, produced the largest volume of beer in 2008. Yanjing Beer occupied a dominant 50 percent market share in North China, and more than 90 percent of the Beijing market.

### **Dairy**

The dairy industry in the region also large. Inner Mongolia is home to the top two dairy giants in China, Mengniu and Yili. Hebei, Beijing, and Shandong etc. are also on the top of dairy provinces list in China. Mengniu, Yili and Sanyuan (Beijing) are the three major brands in the Beijing market.

### **Emerging City Markets**

Apart from Beijing, North China hosts a big group of emerging city markets, including Tianjin, Qingdao, Zhengzhou, Xi'an, Taiyuan, Urumqi, Hohhot and Shijiazhuang. These cities have experienced robust development over the past years at an average yearly growth of ranging from 15 to 20 percent, much higher than the national average. Companies that are aiming at expanding their China market should never ignore these places.

**Figure 14: The Food Processing Industry in Northern China by Province 2008\***

Provinces	Categories	Number of Enterprises	Annual Sales (1 billion RMB)
<b>Beijing</b>	Food Processors	225	23.3
	Food Manufacturers	210	14.5
	Beverage Manufacturers	67	13.2
<b>Tianjin**</b>	Food Processors	163	27.5
	Food Manufacturers	138	13.7
	Beverage Manufacturers	50	9.6
<b>Henan</b>	Food Processors	1764	213.8
	Food Manufacturers	491	71.7
	Beverage Manufacturers	369	44.7
<b>Shandong</b>	Food Processors	4507	582.4
	Food Manufacturers	1252	144
	Beverage Manufacturers	538	67
<b>Shaanxi</b>	Food Processors	251	21.9
	Food Manufacturers	118	10.2
	Beverage Manufacturers	95	14.1
<b>Shanxi</b>	Food Processors	139	9.9
	Food Manufacturers	92	5.8
	Beverage Manufacturers	58	6.2
<b>TOTAL</b>		10527	1293.5

Sources: Statistical Yearbook 2009 of the reported provinces

\* Enterprises refer to those only with an annual sales revenue of exceeding RMB5 million.

\*\*Numbers of enterprises are from the Yearbook 2008.

#### 1.5.4. Southwest China

Southwest China, which covers Sichuan, Yunnan, Guizhou provinces, Chongqing Municipality and Tibet Autonomous region, has a population of 200 million and a regional GDP of \$398 billion (2008). Sichuan province is the powerhouse in the region, and shares borders with Chongqing in the east, Yunnan and Guizhou in the south and Tibet Autonomous region in the west. Chengdu, Chongqing, Kunming and Guiyang are the major leading economic development cities in this region. Reflecting China's commitment to market development in China's interiors, growth for the regions' largest cities has been among the highest in the nation. With 19 million hectares cultivated land, about 15.7 percent of total national arable land, Southwest China region produced \$107 billion value of agricultural products in 2008, accounting for 26.8 percent of region's total GDP. This gives abundant resources for the food processing industry in Southwest China.

There are more than 3,100 food processing companies in the Southwest China region. About 57 percent are food processors, 19 percent are food manufacturers and 24 percent are beverage manufacturers. Sichuan province leads the food processing industry in the region, accounting for about 64 percent of the food processors and manufacturers in this region and 46 percent of the region's total GDP.

**Figure 15. Food Processing Industry in Southwest China by City and Province 2008\***

Provinces & Cities		Number of Enterprises	Gross Output (billion RMB)
Sichuan	Food Processors	1103	123.3
	Food Manufacturers	395	25.9
	Beverage Manufacturers	488	78.1
Chongqing	Food Processors	283	19.6
	Food Manufacturers	104	5.5
	Beverage Manufacturers	60	6.5
Yunnan	Food Processors	231	20.1
	Food Manufacturers	53	2.5
	Beverage Manufacturers	112	6.7
Guizhou	Food Processors	138	5.5
	Food Manufacturers	50	4.2
	Beverage Manufacturers	92	15.1
Regional Total		3109	312.8

*Data source: Sichuan, Chongqing, Yunnan, Guizhou Statistical Year Books 2009*

*\* Latest available data, including only those enterprises that realized annual sales over US \$ 735,294 (RMB 5 million) in FY 2008*

*\* US \$ 1 = RMB 6.8*

### **Food Processing Industry in Southwest China**

As export is not the dominant revenue source for the food processing industry in Southwest China, the industry was not affected by the global economic downturn, but still developing rapidly. The leading manufacturers have gained more market share by merging the small scale processors and expanding dramatically, thus the number of large scale manufactures keeps increasing. Due to intense competition, many small scale factories or plants were squeezed out of the market or got merged by big players in the industry. The top one hundred manufacturers are making more than half of the total sales value and revenue of that of the whole industry. In order to be more competitive in the industry, all manufacturers are trying their best to adopt new technologies, develop new products, and improve safety standards to meet higher export requirements.

More and more leading national and multinational manufacturers also began to enter this emerging Southwest China market and are expected to gain a higher market share. With less competition, leading manufacturers will find it easier to gain market share in the region. President Enterprises (China) Investments built their \$20 million processing factory in Chengdu, Sichuan in 1993, and now Chengdu Uni-President Enterprises Food Co. Ltd. is the largest food processing company in Sichuan in terms of sales volume. Ting Hsin International Group also performs strongly in Southwest China due to strong marketing strategies, and they have been present in bakery products, dairy products, noodles and baby food. Coca-Cola set up Chengdu Coca-Cola Beverage Co., Ltd. in 1996, and has ever since played a big role in the local beverage market. In 2008, Pepsi set up the largest soft drink production factory in West China in Chongqing. Pepsi plans to open a new beverage manufacturing plant in Kunming over the next two years. Leading sauces manufacturer Lee Kum Kee is also planning to strengthen

its presence in Southwest China, as it is already performing well in East and South China regions. Foreign investment in food processing industry is likely to increase in Southwest China. Low production costs including low rental costs, labor costs and raw material costs in the region will remain attractive to multinational manufacturers.

The strong flavors and hot and spicy foods preference of consumers in Southwest China creates a high demand for condiments, spices, sauces and pickle products, thus a lot of local leading food processors are manufacturing condiments, sauces or pickle products. Key manufacturers, such as Sichuan Haoji Food Co. Ltd, Chengdu Jingong Weiye Food Co. Ltd, Sichuan Pixian Bean Paste Co., Ltd., Guiyang Nanming Laoganma Flavoring Food Co. Ltd., Chongqing Zijialu Spice Co., Chongqing Fuling Pickled Product Group, and Chengdu Xinfan Kraut Co. Ltd, are the most popular brands manufacturers and main suppliers to foodservice operators not only in this region but also nation-wide.

### **Sichuan**

The major food processing sectors in Sichuan include liquor, beverage, meat processing, animal feed, edible oil, and cereal, and major manufacturing products are liquor, soft drinks, rice and flour products, snack foods, frozen products, refined tea, dairy products, canned/preserved products, and seasoning products. The processors and manufacturers are mostly located in the fast growing emerging cities like Chengdu, Yibin, Luzhou, Ziyang, Nanchong, Neijiang, Deyang, Zigong, and Suining. These areas contribute over 79 percent to the province's food processing industry. Sichuan is famous for alcohol production and has a long history of liquor consumption. With annual production of 1.12 million tons (2008), Sichuan province is the number one liquor production area in China. Lu Zhou Lao Jiao, Jian Nan Chun, Wu Liang Ye, Lang Jiu and Tuo Pai liquor manufacturers in Sichuan are the leading liquor manufacturers nation-wide. The liquor production sales value reached \$6.5 billion in 2007. Beverage manufacturing, with 2.5 million tons production output and \$1.14 billion net profit in 2008, is contributing to half of the total revenue of the food processing industry in Sichuan. Sichuan's beverage production output ranked number eight nationally, accounting for about 4 percent of the country's total beverage production output. Fruits juice beverage production alone reached 684,500 tons in 2007, and ranked number six nationally.

### **Yunnan**

Yunnan province is well-known for its sugar, tea, and wine production in the food processing industry. In 2008, the sugar production reached 2.1 million tons, refined tea 97,874 tons, and wine 7,025 kiloliters. The sales value for sugar products reached \$807 million (2007). There are about 5,680 tea processing factories in Yunnan, processing more than 450,000 tons of tea annually, including red tea, green tea, Wulong tea, PuEr tea, jasmine flower tea, and instant tea. Yunnan is famous for its extraordinary PuEr tea which was identified as a very healthy tea by Chinese scientist. During a three-day Tea Trade Fair in 2007, USD \$183.4 million worth of purchasing contracts were signed on-site for PuEr tea, and about 28 joint projects for PuEr tea were signed

bringing another USD \$156 million worth of contracts. Yunnan's wine production is proudly ranked number ten in China, with annual output of 8,170 kiloliters (2007), worth of USD \$ 17.4 million. The main vineyards in Southwest China are located in Yunnan-Guizhou Plateau. Grape cultivation has a long history in Yunnan. Yunnan Gaoyuan Wine Co.,Ltd and Yunnan Shenquan Wine Co.,Ltd. are the two biggest wineries in Southwest China. Yunnan Gaoyuan Winery now has 1334 hectares of premium vineyard growing a lot of grape varieties including Rose Honey, Merlot, Cabernet Sauvignon, Grenache, Yan73, Italian Riesling and Chardonnay. The growing area of Merlot and Cabernet Sauvignon is the biggest in this area. Their wine brand Yunnan Hong and Shangri La become famous brands in wine industry and ranks sixth in Southwest China and has been more competitive due to their distinctive market and special flavor.

### **Chongqing**

The major food processing products in Chongqing are beer, pickle products, processed meat products, condiment/seasoning products, canned/preserved products and dairy products. Chongqing's leading beer Chongqing Beer's production output was 312,189 kiloliters in 2007, ranked the number six in China in terms of annual output. Its dairy production reached 92,900 tons in 2008, the highest in Southwest China. As pickle products like vacuum packaged pickled poultry products are very popular products in Southwest China, U.S. poultry products such as turkey wings, wingtips, chicken paws, and chicken wingtips have gained great market share in the poultry products processing industry recent years. Chongqing's condiment products like packaged hotpot condiments are also sold pretty well all over China.

### **Guizhou**

The food processing industry in Guizhou is less developed compared with other major food processing areas in Southwest China. Its production output for liquor, beer, beverage, dairy products and canned products were separately 183,500 kiloliters, 232,800 kiloliters, 312,200 tons, 35,578 tons, and 9,150 tons.

### **Southwest China Consumer Trends & Opportunities for U.S. Ingredients Suppliers**

As for consumer trends, demand for convenience, health, low-fat and fortified processed products is expected to grow in Southwest China in the next five years. Compared with the high percentage (80 percent) of processed food consumption in Western countries, the percentage of processed food consumption in China is only around 30 percent, and even lower in the Southwest China region. With sustained and rapid growth of per capita disposable income, consumers in urban areas of Southwest China show more interest in value-added processed food items which are more convenient, healthier, of better quality and of more variety choices. This creates demand for U.S. processed foods and ingredients. The popular value-added food items are dairy products, baby foods, oils and fats, meats, poultry and seafood. Baked goods and processed cereals are increasingly accepted by local consumers as well. Thriving catering companies and the booming restaurant sector are also increasing demand for value-added processed products. Consumers in Southwest China also become increasingly focusing

on products' quality, flavor and nutrition in addition to price. This would boost sales of U.S. high-quality rice, soybean, corn, dried fruits and nuts, and premium canned or packaged food products. Love of strong flavors in this region provides tremendous sales opportunities for U.S. high-grade sauces, dressings and condiments manufacturers. When targeting this area's customers, U.S. food manufacturers may consider adding local preferred flavors, and some popular herb extracts ingredients such as honeysuckle and chrysanthemum, which are treated as healthy ingredients in local market. The organic market is also promoted by the government and organic products are welcomed by consumers because of health and safety concerns. As the healthy eating trend becomes more popular, the consumption of better quality U.S. food products would for sure increase by a large portion. Having good image of quality, health, and safety, U.S. food products and ingredients would find large potential market in this area.

## **SECTION II. ROAD MAP FOR MARKET ENTRY**

### **2.1. Entry Strategy**

Being the largest food consumption market and the most dynamic food processing country in the world, China is always one of the top considerations for food ingredients producers and exporters aiming at expanding their businesses. Apart from the general business rules, it's recommended that those who are interested in the China market consider the following issues prior to coming to China.

One, the **China market is immense and opportunities are ample**. The China market is huge, and ready to accept many different price ranges and products from around the world.

Second, **China is not a unified market and thorough market research is critical before trading with China**. The China market is extremely diverse and fragmented by product types, regional differences, age group preferences, and different regional players.

Three, it is critical to find **good importers and distributors**. Try to find those who have established wholesale/retail outlets and relationships in the target market. They should not only be able to make orders for a product but also ensure the product is selling on the market and can grow in the future. Where possible, it is recommended to visit their facilities and warehouses especially when a product is highly perishable.

Four, **trade shows** can be a cost effective approach to understanding the market and meeting agents/importers. Some valuable shows in China include FHC (Food & Hotel China), China Fisheries & Seafood Expo, SIAL China, China International Meat Industry Expo, Bakery China Show and FIC (Food Ingredients China). The ATOs have more information on these events.

Five, be open to **different importing channels**. Lean economic times in 2009 have driven some processors,

manufacturers and hypermarkets to consider direct sourcing of products from producers to reduce costs. However, in some cases it might not be possible to get into China market while bypassing importers/distributors.

Six, **Chinese business culture matters**. The most distinctive highlight of the Chinese business cultures is the need to cultivate Guanxi, or relationships. Conventionally, Chinese value friendships very much, which implies that if one has a connection with the potential Chinese partner, he may get a better price, or be favored among other competitors. Although the influence of Guanxi is slowly falling as China modernizes, it is still very important.

All of the ATO offices (Beijing, Shanghai, Guangzhou, Chengdu and Shenyang) are prepared to provide assistance to U.S. exporters, including providing updated market information, organizing reverse study tours, and attending trade shows. Exporters are welcome to take advantage of these services. In addition, the representative offices of the cooperators in China are another important source for information and assistance.

## **2.2. Market Structure**

### **2.2.1. Distribution pattern**

#### **Traders/Importers**

Exporters can sell their products through Chinese importers, which is the most traditional pattern of distribution. Several years ago, importers were still limited to a small number of state-owned companies that were not real importers, but just sold importing rights. Sometimes they also provided other associated services such as handling customs and logistics documentation, facilitating government inspection and certification processes and remitting payment for the imported products to the real importers. This old patterns has changed. Any registered company can now import and export most food products. Therefore, it is the exporter's decision to select those who are reliable and have developed sales and distribution networks.

#### **Direct Distribution.**

The manufacturers/exporters set up their sales outlets and sell their products directly in China rather than through a local business organization or person. The advantage is that the manufacturers/exporters can meet the consumers face to face and learn about market conditions and trends. They can also control who buys and distributes their products. The drawback of this approach is the need to invest in developing a sales network and the high cost of learning to operate in a foreign market.

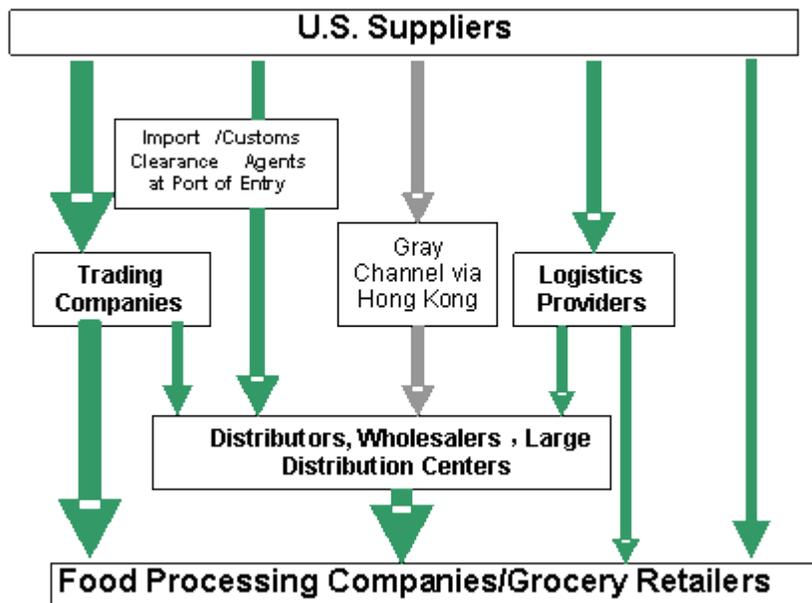
#### **Direct Selling to Large Sellers/Processors/Manufacturers**

Some large sellers/processors/manufacturers are considering direct sourcing products from exporting countries to reduce costs. If connections to the supplier can be established, this could be an opportunity for producers/exporters. This practice is spreading rapidly. For example, some major Beijing hypermarkets and supermarkets now source 30 percent of fresh fruit and vegetable products directly from farmers. By doing so, hypermarkets would be able to enhance traceability for the products purchased while reduce costs by 20-30 percent.

Whatever options to take, the importing process may involve services from logistics providers and/or customs clearance agent.

The flow chart below is a summarization of important channels.

**Figure 16: Distribution Flow Chart**



Source: Industry Sources

Note: USDA strongly discourages the use of the gray channel.

### 2.2.2. Distribution channels

In addition to legal channels, there is a Gray Channel which refers to shipments via third country and Hong Kong importers that have distribution connections on the mainland. The goods are often shipped outside of official channels. There are serious problems with this approach. For example, the U.S. supplier has little control over their product after it ships and technical support is difficult to provide because exporters do not know their consumers. In addition, this channel is subject to closure at any time. Since this channel is illegal in

China, USDA strongly discourages its use.

### 2.2.3. Distribution flow

China is generally divided into three regions.

**North China:** including Beijing, Tianjin, Heilongjiang, Jilin, Liaoning, Hebei, Shanxi, Shaanxi, Ningxia, Qinghai, Xinjiang, Gansu, Henan, and Shandong. Imports to these provinces would normally come into China through the major ports including Tianjin, Qingdao, Dalian, and Qinhuangdao.

**East China,** which includes Shanghai, Jiangsu, Zhejiang, Anhui, Fujian, Jiangxi, Hubei, Hunan, Chongqing, and Sichuan. Ports like Shanghai and Ningbo are the largest.

**South China,** mostly Guangdong, Guangxi, Guizhou, and Yunnan.

Goods that come into China through the major ports of the three regions will flow to regional distribution centers, such as Shenyang for Northeast, Xi'an for Northwest, Wuhan for Central China, and Chengdu for West China and so on. In these cities, products will be further wholesaled or distributed to big end users or third tier cities in each region.

**Figure 17: Volume of Freight Handled in major Coastal Ports 2004-2008** (10, 000 tons)

Seaport	2004	2005	2006	2007	2009
Shanghai	37,896	44317	47040	49227	50,808
Ningbo-Zhoushan	22,586	26881	*42387	47336	52,048
Guangzhou	21,520	25036	30282	34325	34,700
Tianjin	20,619	24069	25760	30946	35,593
Qingdao	16,256	18678	22415	26502	30,029
Dalian	14,516	17805	20489	24893	24,588
Qinhuangdao	15,037	16900	20046	22286	25,231
Total	148,430	173686	208419	235515	252,997

Source: China Statistical Yearbook, 2009

\* from 2006, Ningbo-Zhoushan Port includes the previous Ningbo Port and Zhoushan Port. Statistics prior to 2006 refers to the previous Ningbo Port only.

### 2.2.4. Cold Chain

Every year, cold chain logistical problems in China result in massive product losses. In 2008, it was estimated that each year China lost \$9.25 billion of food products in transportation. For perishable products such as fruits and vegetables, total losses account for about 25 to 30 percent of total fruit and vegetables production.

These losses occur largely because only 15 percent of all perishable products are transported by refrigerated

vehicles – compared to nearly 90 percent in developed countries. Currently about 90 percent of meat products, 80 percent of aquatic products and a large amount of dairy products are shipped without cold chain logistics. While frozen food usually has better cold chain logistics, breaks of cold chain still happen often as products move into markets.

A major problem is inadequate facilities and equipment along with some management issues. For example, cold storage capacity in China covers only about 25 percent of total output, compared to 70 to 80 percent in developed countries. China currently has 30,000 refrigerated vehicles, which is only 0.3 percent of total cargo transportation. Meanwhile, there are only 6,970 refrigerated railcars, which comprise only 2 percent of China's total 338,000 railcars. Only about 25 percent of perishable food is transported with the refrigerated railcars, which is only 1 percent of total amount of the total rail transportation. Total cold storage capacity is about 7 million square meters, and is mainly used for the storage of meat and aquatic products. In addition, many cold storage facilities are vastly out of date, forcing products to be moved manually and hand stacked. This increases mistakes. Location compounds the problem: cold storage warehouses generally are in major port cities, but few are close to their supply bases or China's agricultural producing regions.

In addition, there are no consistent standards for food quality and safety and inadequate inspection and ineffective enforcement. Fragmented, unclear rules and regulations exacerbate cold chain problems. There are no national laws or regulations governing food safety in storage, transportation, distribution and retail. Although these are under development, it will be a few years before national cold chain standards are ready.

The supply of cold chain services has not kept up with demand. The need for capable third-party logistics services providers (3PLs) in China is acute. The country has more than 510,000 such companies but most, however, only offer basic transportation and storage services. As a result, most logistics for perishable foods is accomplished by the enterprises themselves at high cost or the marketing enterprises with little involvement of the 3PLs.

Finally, China's cold supply chain is overseen by a complex mix of authorities, including different government ministries and agencies. China's vast territory and broad differences in climate and temperature are a unique challenge to the long-haul transport of perishable foods. Massive distances also mean that the needs of less developed communities in China's interior generally go unaddressed.

Having realized the urgent needs of a developed cold chain transportation system, the "National Food Industry 11th Five-Year Plan" first raised the concept of establishing a modern food logistics system. It encouraged enterprises to set up modern logistics systems for the food products and actively explore the rural market through improving logistics systems of the rural food market. During the 11th Five-Year period, the government plans to improve food safety by establishing a better food cold chain logistics system.

There will also be money for the sector. In response to the global economic recession, the Chinese government

has raised the RMB Four Trillion Stimulus Plan, where logistics industry has been selected to join other nine other light industries to share funding.

### 2.3. Company Profiles

**Figure 18: Top Companies in Different Food Sectors 2007 (RMB million)**

<b>Company</b>	<b>Total Revenue</b>	<b>Major Products</b>	<b>Production Location (City, Province)</b>
<b>Meat Products and Sideline Products Processing</b>			
Xingcheng Jinluo Meat Products Co., Ltd	2000+	Chicken Products	Linyi, Shandong
Luohe Shineway Group Co., Ltd	2000+	Meat Products	Luohe, Henan
Delisi Group Co., Ltd	2000+	Meat Products	Weifang, Shandong
Yurun Food Co., Ltd	2000+	Cooked Meat Food	Nanjiang, Jiangsu
<b>Frozen Aquatic Products Processing</b>			
Homey Group Co., Ltd	2000+	Marine Products	Weihai, Shandong
Xixiakou Group Co., Ltd	2000+	Aquatic Products	Weihai, Shandong
<b>Fish Surimi and Dry &amp; Preserved Aquatic Products</b>			
Longshan Eel Industry Joint Company	1500-2000	Roast Eel	Zhenjiang, Jiangsu
Xulong Food Group	1000-1500	Roase Eel	Ningbo, Zhejiang
Tengxin Food Stock Co., Ltd	1000-1500	Fish Ball	Fuzhou, Fujian
Changhua Aquatic Foodstuffs Co., Ltd	1000-1500	Imitated Crab Meat	Rizhao, Shandong
Baiyang Sea Foods Co., ltd	500-1000	Aquatic Products	Fuzhou, Fujian
Ayeshan Group	300-500	Imitated Crab Meat	Rizhao, Shandong
<b>Vegetable, Fruit and nut Processing</b>			
Strong Fruit Jelly manufacturing co., Ltd	2000+	Fruit jelly	Yangjiang, Guangdong
Dongsheng Group	1500-2000	Peanut Products	Qingdao, Shandong
Wanfu Group	1000-1500	Quick-Frozen Vegetables	Qingdao, Shandong
Huatai Food Co., Ltd	500-1000	Melon Seeds	Hefei, Anhui
<b>Pastry and Bread</b>			
Christing Food Co., Ltd.	1500-2000	Cake	Shanghai
Orion Food Co., Ltd	1500-2000	Chocolate Pie	Langfang, Hebei
<b>Biscuit and Other Baked Foods</b>			
Pepsico Snack (China) Co., Ltd.	2000+	Food	Shanghai
Dali Food Co., ltd	2000+	Food	Jinan, Shandong
<b>Candy and Cholate</b>			
Xsu-Chi Food	2000+	Candy	Dongguan, Guangdong
Wrigley Chewing Gum	2000+	Chewing Gum	Guangzhou, Guangdong
<b>Quick Frozen Foods</b>			
Longda Food	2000+	Food	Yantai, Shandong
Tianjing Food	2000+	Food	Changchun, Jilin

<b>Liquid Milk and Dairy Products</b>			
Mengniu Dairy Group	2000+	Dairy products	Huhhot, Inner Mongolia
Yili Industrial Group	2000+	Dairy Products	Huhhot, Inner Mongolia
Bright Dairy & Food	2000+	Dairy Products	Shanghai
<b>Canned Meat and Poultry</b>			
Fuxi Foods	2000+	Frozen meat	Shanghai
Fengcheng Huaying Fowl Industry	1000-1500	Poultry	Yichun, Jiangxi
<b>Canned Seafood</b>			
Haishen Foods	1000-1500	Canned Food	Ningbo, Zhejiang
Dongfang Canned Food	300-500	Canned Food	Foshan, Guangdong
<b>Canned Vegetable and Fruits</b>			
Maling Aquarius	2000+	Canned Food	Shanghai
Yeshu Group Haikou Canned Food	1000-1500	Beverage	Haikou, Hainan
<b>Soy, Edible Vinegar and Similar Products</b>			
Haitian Flavouring Food	2000+	Soy Sauce	Foshan, Guangdong
Hengshun Group	2000+	Vinegar	Zhenjiang, Jiangsu
<b>Nutritious and Health Care Food</b>			
Wang'S Bee Garden	1500-2000	Bee Products	Nanchang, Jiangxi
Perfect (China)	1000-1500	Health Foods	Zhongshan, Guangdong
<b>Frozen Beverages and Edible Ice</b>			
Walls (China)	1000-1500	Ice Cream	Beijing
Walls (China) Taicang	500-1000	Frozen Beverage	Suzhou, Jiangsu
<b>Liquor</b>			
Wuliangye Group	2000+	Distilled Spirit	Yibin, sichuan
Xinghuacun Fen Chiew Group	2000+	Distilled Spirit	Lvliang, Shanxi
Chian Kwechow Moutai Distillery	2000+	Distilled Spirit	Zunyi, Guizhou
<b>Beer</b>			
Yanjing Beer Group	2000+	Beer	Beijing
Zhujiang Beer	2000+	Beer	Guangzhou, Guangdong
Tsingtao Brewery	2000+	Beer	Qingdao, Shandong
<b>Fruit &amp; Vegetable Juice and Beverage</b>			
North Andre Juice co., Ltd	2000+	Syrup	Yantai, Shandong
Haisheng Fruit Industry Development	2000+	Syrup	Xi'an, Shanxi

Source: China Markets Yearbook 2008

Note: This figure was not updated in 2009.

### SECTION III. COMPETITION

**Figure 19: Ingredients Competition 2010**

Product Category	Major Supply Sources in 2009	Competitions and Trends
Poultry (0207) Import value: \$983.518 mil	<ul style="list-style-type: none"> <li>• U.S. \$826.824 mil, 84.07 percent</li> <li>• Argentina \$92.445 mil, 9.4 percent</li> <li>• Brazil \$42.857 mil, 4.36 percent</li> </ul>	<ul style="list-style-type: none"> <li>• The U.S., Argentina, and Brazil products accounted for over 97 percent of total imports. Most U.S. products were chicken paws, followed by leg quarters and drumsticks, wingtips, chicken wings, turkey products and gizzards. Chicken paws are warmly welcomed in South China while leg quarters and drumsticks are consumed heavily in Northwest China.</li> <li>• It is estimated China's strong demand will drive its 2010 imports to a new high if trade issues can be resolved (see below).</li> <li>• On February 13, 2010, China began requiring duties on U.S. broilers in the form of cash deposits ranging from 43 to 105 percent as a result of its preliminary determination in China's anti-dumping investigation of U.S. poultry, which has led to a sharp decrease of U.S. poultry products export to China.</li> <li>• Exports from Argentina and Brazil to China are expected to grow substantially because of less competition from the United States.</li> </ul>
Pork (0203) Import value: \$136.045 mil	<ul style="list-style-type: none"> <li>• Denmark \$38.942 mil, 28.62 percent</li> <li>• Canada \$34.170 mil 25.12 percent</li> <li>• U.S. \$23.714 mil 17.44 percent</li> <li>• Spain \$22.135 mil 16.28 percent</li> </ul>	<ul style="list-style-type: none"> <li>• China's huge 2008 imports were caused by the short domestic supply. This was offset by a recovery in domestic production in 2009.</li> <li>• The swine price alert system established in 2009 has contributed to stabilizing domestic production.</li> </ul>
Beef (0202) Import value: \$36.474 mil	<ul style="list-style-type: none"> <li>• Australia \$14.427 mil, 39.45 percent</li> <li>• Uruguay \$12.964 mil, 35.62 percent</li> <li>• New Zealand \$6.811 mil, 18.63 percent</li> </ul>	<ul style="list-style-type: none"> <li>• China's import value soared from less to \$10 million to nearly \$36.5 million in 2009, a 250 percent increase, as a result of increasing demands by high end hotels and restaurants.</li> <li>• Australia maintained its position as the predominant supplier to China, although its share dropped from over 60 percent to less than 40 percent.</li> <li>• The market remains closed to U.S. products because of the BSE ban.</li> </ul>
Fish and	<ul style="list-style-type: none"> <li>• Russia \$1,185.917mi ,</li> </ul>	<ul style="list-style-type: none"> <li>• Russia and U.S. are the top two exporters of</li> </ul>

<p>seafood (03) Import value: \$3,603.702 mil</p>	<p>32.91 percent</p> <ul style="list-style-type: none"> <li>• U.S. \$548.681 mil , 15.22 percent</li> <li>• Norway \$273.779 mil , 7.6 percent</li> </ul>	<p>seafood to China.</p> <ul style="list-style-type: none"> <li>• While Russia was still No. 1, it is worth noting Russia has been losing its market share gradually; the U.S., on the contrary, has been making small but steady gains in the market over the past three years.</li> <li>• Norway has taken the lead in selling fresh salmon to China for domestic consumption. It has built a high quality image of its seafood in the minds of the Chinese consumers, after aggressive marketing promotion of over ten years in China.</li> <li>• About 40 percent of China's seafood imports were processing trade driven and re-exported to other countries. The United States was the second largest seafood exporter to China and at the same time the largest seafood importer from China.</li> <li>• Deterioration of fishery resources and overfishing continue threatening domestic fishery ecological environment, China's seafood import is expected to keep increasing over the years to come.</li> </ul>
<p>Dairy (04) Import value: \$1,048.340 mil</p>	<ul style="list-style-type: none"> <li>• New Zealand \$585.862 mil, 55.88 percent</li> <li>• France \$103.638, 9.89 percent</li> <li>• U.S. \$103.093, 9.83 percent</li> <li>• Australia, \$73.309, 6.99 percent</li> </ul>	<ul style="list-style-type: none"> <li>• For years, New Zealand, the U.S., Australia and France have been taking the lead on exporting dairy products to China.</li> <li>• Impacted by the melamine scandal, China's dairy trade experienced extremes in 2008: a record high export growth in the first nine months and then a drastic import growth since the scandal began.</li> <li>• Taking advantage of the melamine scandal, New Zealand successfully expanded its market share in China from over 30 percent to over 50 percent.</li> <li>• Although domestic manufacturers have managed to regain their market in the past a year and a half, it would take a long time for the industry to win the lost trust back.</li> </ul>
<p>Edible Fruits and Nuts (08) Import value: \$1,717.928 mil</p>	<ul style="list-style-type: none"> <li>• Thailand \$493.047 mil – 24.69 percent</li> <li>• Vietnam \$301.255 mil – 17.69 percent</li> <li>• U.S. \$284.256 mil – 15.31 percent</li> </ul>	<ul style="list-style-type: none"> <li>• This category could be separated into fresh fruits and dried fruits/nuts. Thailand, the U.S., Philippines, Vietnam, Chile, New Zealand, Australia and South Africa are the main exporters of fruits, and the U.S., Russia, Iran and South Korea are the main nut exporters to China.</li> <li>• While the U.S. was behind Thailand and Vietnam in total export value, it did well on</li> </ul>

		nuts exports. Due to the fast developing snack food sector and bakery sector, where dried fruits/nuts are largely used, the U.S. exported \$105.4 million of nuts in 2009, comparing the \$16.4 million of 2006, an average annual growth rate of close to 100 percent.
Baking related (19) Import value: \$1,010.730 mil	<ul style="list-style-type: none"> <li>• Singapore, \$325.062, 32.18percent</li> <li>• New Zealand \$214.254, 21.19 percent</li> <li>• Australia, \$108.249, 10.69 percent</li> <li>• U. S. \$23.898, 2.38 percent</li> </ul>	<ul style="list-style-type: none"> <li>• The U.S. was weak in this sector, after a long list of competitors, and took only two percent of the total market.</li> <li>• Over the past ten yeas, the U.S. share has been shrank drastically, from the highest 28.71 percent in 1999 to the present share.</li> <li>• Bakery sector is one of the fastest developing and most promising food sectors in China. Over the past three years, the total import value has nearly tripled from \$360 million to \$1,010 million.</li> <li>• The Moon Cake Festival, or the Mid Autumn Festival, could be a good opportunity for U.S. exporters. Dried or processed fruit ingredients, nuts, as well as light flavored cheese have good potential since they add health and nutritional benefits. Various high quality U.S. ingredients such as cranberries and almonds have been creatively mixed with conventional lotus seed puree or multiple nuts in some recipes.</li> <li>• Domestic products, while cheap in price, are less competitive in both variety and quality compared with imported products.</li> </ul>

Source: World Trade Atlas and USDA GAIN Reports

#### SECTION IV. BEST PRODUCT PROSPECTS

Figure 20: Best Product Prospects 2010

Ranking	Product Categories	2004 imports (\$ mil)	2009 Imports (\$mil)	percent 5 Yr. Avg. Annual Growth	Import Tariff Rates (percent)	Remarks
1	Baking related (19)	195	1011	38.98	Varies from 10 to	<ul style="list-style-type: none"> <li>• The baking sector in China has been</li> </ul>

					30	growing at an annual average rate of 30 percent for about ten years, and is expected to evolve at this speed for another decade.
2.	Cheese and curd (0405) and Butter, oils from milk (0406)	46	136	24.21	10, 12 or 15, depending on specific products	<ul style="list-style-type: none"> <li>Influenced by the western cuisine, demands for these products are growing rapidly, and expected to continue booming substantially.</li> </ul>
3	Poultry (0207)	335	984	24.05	Generally 20, 10 or 5 for several items	<ul style="list-style-type: none"> <li>Heavy duties imposed on U.S. products have sharply reduced the U.S. export volume although demand is strong.</li> </ul>
4	Fruits and nuts (08)	619	1,718	22.65	Varies from 10 to 30, depending on different products and purposes	<ul style="list-style-type: none"> <li>Falling prices on imports and strong domestic demand beefed up this sector.</li> <li>Nuts are expected to see further robust growth over the coming years because of rapid development in the bakery and snack food sectors.</li> </ul>
5	Pork (0203)	54	136	20.29	20 for fresh and chilled and 12 for frozen	<ul style="list-style-type: none"> <li>China considers pork a priority sector for local production with imports used to make up for local shortfalls.</li> <li>However, increasing consumption could fuel growth in the future years.</li> </ul>

6	Milk, cream, concentrated or sweetened (0402)	236	587	19.99	10	<ul style="list-style-type: none"> <li>Higher quality and better reputation of foreign manufacturers would win importers market share.</li> </ul>
7	Whey (0404)	120	284	18.80	6 for whey and modified whey and 20 for others	<ul style="list-style-type: none"> <li>Impacted by the financial crisis, China's whey imports have fluctuated over the past two year. But over the long run, this product should see strong sales growth in China.</li> </ul>
8	Fish (frozen, not fillets) (0303)	1,517	2,711	12.31	10 or 12	<ul style="list-style-type: none"> <li>Since 40% of China's seafood imports are processing trade driven and re-exported to other countries, higher entry standards set by Japan and other countries may impact China's exports, and in turn influence its imports from U.S.</li> </ul>

Source: World Trade Atlas, Customs Import & Export Tariff of China and USDA GAIN Reports

Note: The items in the list are ranked in order of five year average annual growth rate, which provides an indication of their potentiality in the market.

## SECTION V. POST CONTACT AND FURTHER INFORMATION

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