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HRI Food Service Sector Annual Report

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Report Highlights:

China's economy slowdown has shown its negative impact on the expansion of food service industry. Food safety scandals continued to be exposed, in return, the scared consumers reduced their dining-out frequency. In addition, the government policy of reducing public funds on lavish expenditures deeply impacted high-end hotels and restaurants. The industry had adopted various strategies to overcome the difficulties. While first-tier cities remain the strongest centers of consumption and spending in the Hotel, Restaurant and Institutional Sector, the industry will continue to grow substantially in Emerging City Markets.

Post:
Guangzhou ATO

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General Information:

SECTION I. MARKET SUMMARY

A. The Economy: Slowing But Still Dynamic

GDP

Three decades of uninterrupted growth coupled with the massive size of the potential consumer market have made China a key export target. Nonetheless, China has entered a new phase marked by decelerating economic growth. Real GDP grew 7.7% in 2012 and 7.5% in 2013, the lowest growth rate achieved in the past 14 years. The People's Bank of China estimates that real GDP growth should slow to 7.4% in 2014 and 7.1% in 2015. According to a recent study by the U.S. Federal Reserve, it puts China's growth rate at about 6.5% by 2030.

China has entered a new era, as it seeks to transition from an investment and export-led economy to consumption-led growth. Despite the inevitable bumps and backtracking along this path, this transformation is expected to result in economic growth that is more sustainable for the long term. In September 2013, China officially announced a plan for Shanghai Free Trade Zone, that, when completed in an estimated 10 years, will make Shanghai a major hub for domestic and international businesses. Then, in December 2014, China announced its plan to establish similar Free Trade Zones in Guangdong, Fujian and Tianjin. Meanwhile, China continues to face a series of domestic and international challenges in the form of an aging population, social inequalities (particularly between urban and rural dwellers), climate change issues and environmental issues.

Shifts in China's economy and society hold good promise for future export development. Per capita disposable income of urban residents reached \$4,419 in 2013, a jump of 12.6% compared with the previous year. China is conducting a massive urbanization program to increase domestic demand, meanwhile, with the improvement in national wealth, the foodservice and retail sectors should see further expansion.

Beginning in 2014, China relaxed its one-child policy. Though the relaxation program will be phased in to minimize its impact on the social infrastructure, it is estimated that the population in China might increase by one million per year due to this new population policy. This policy would have a longer term impact on the demand for U.S. agricultural products.

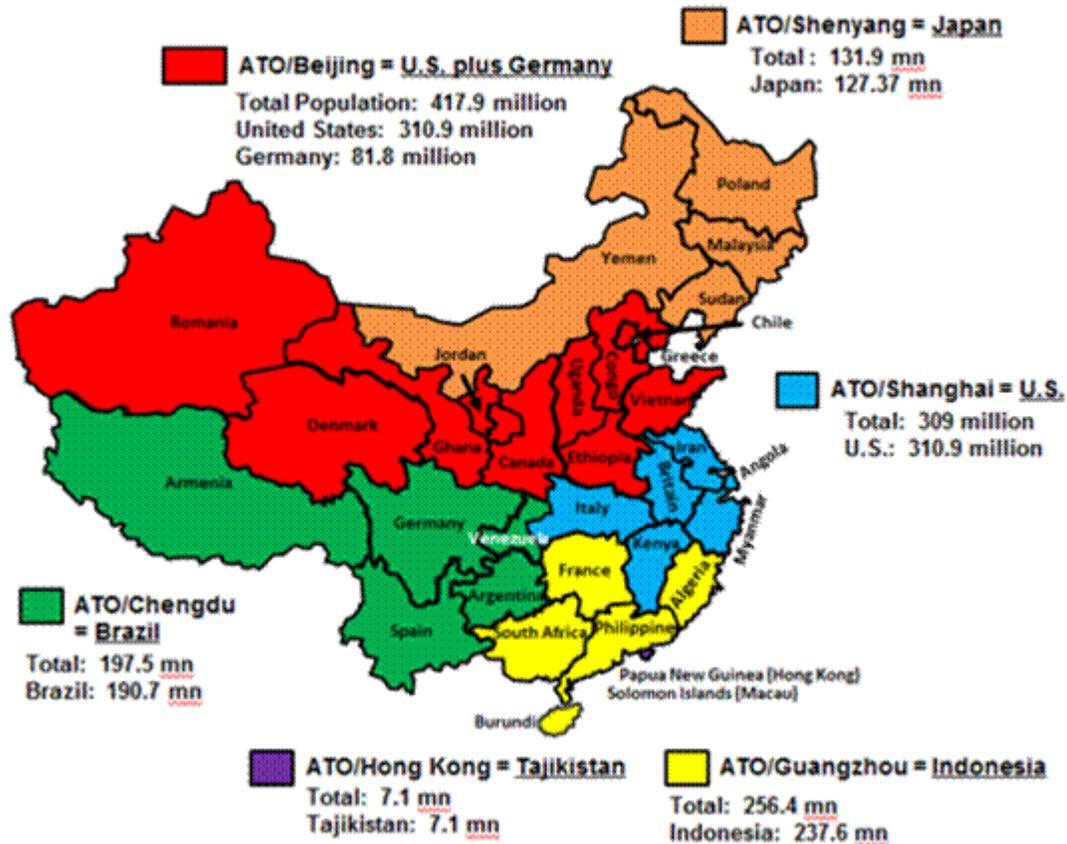
The key factors spurring U.S. agricultural products export are burgeoning consumer demand and the subsequent expansion of the retail and food service industries. Shopping is a major pastime for the Chinese, as is eating out.

Major Economic Indicators at a Glance

Year	Per Capita GDP (US\$)	Per Capita GDP Growth (%)	Total Value of Exports (US\$ Billion)	Total Value of Imports (US\$ Billion)	Per Capita Disposable Income of Urban Households (US\$)	Per Capita Consumption Expenditure on Food of Urban Households (US\$)
2009	4,110	8	1,202	1,006	2,825	695
2010	4,818	17.2	1,578	1,396	3,143	790
2011	5,789	17.3	1,898	1,744	3,587	906
2012	6,319	9.2	2,049	1,818	4,040	994
2013	6,807	7.5	2,210	1,950	4,493	1,052

Source: China Statistical Yearbook 2014

FAS/China Office coverage by region and total population (in millions) with provincial equivalents



Incomes

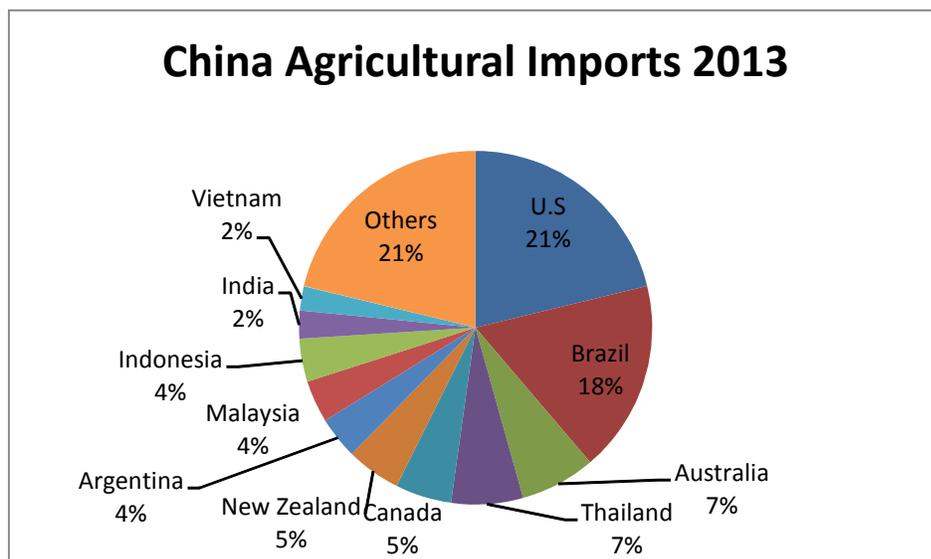
While smaller workforces, and by consequence, increasing wages have begun to strip China of its traditional export competitiveness, per capita disposable incomes continue to increase at double-digit rates. During the period 2012 to 2020, according to Euromonitor, total disposable income will increase by a cumulative of 69.2% in real terms – growing at an average annual rate of 6.8%. The income of urban households is, on average, almost three and a half times higher than that of rural households. Also, the number of urban households with incomes greater than \$5,000 is expected to grow by nearly 25 percent annually over the next ten years, creating tens of millions of new middle-class Chinese consumers.

Exchange Rates

Beginning in July 2005, China reformed the Renminbi (RMB) exchange rate regime by moving into a managed floating exchange rate system with reference to a basket of currencies, and the exchange rate of RMB was re-valued to 8.11 per U.S. dollar on July 21, 2005. As of mid-November 2014, the exchange rate of RMB was 6.1260 per U.S. dollar. Economists generally remain positive about the strength of the RMB, meaning increased buying power for Chinese consumers of U.S. products.

Trade

While China remains the world's leading exporter with a positive trade balance, it is also the world's second largest importer, and a significant net importer of agricultural products. China is the largest international market for U.S. food and agricultural products, accounting for nearly 20 percent of all



U.S. farm exports. Since China joined the World Trade Organization in late 2001, U.S. agricultural exports to the country have grown exponentially – and FAS projects that long-term growth will continue. U.S. agricultural exports to China reached a record \$26.7 billion in fiscal year 2013, with top products including soybeans, wheat, cotton,

corn and forestry products. Only roughly 12% of U.S. exports to China are consumer-oriented. China has attempted to create opportunities for further imports through the issuance of specific fiscal and financial measures to balance trade and organizing import exhibitions, which extend to food and agriculture.

Year	Consumer-oriented Ag Products			Agricultural, Fish & Forestry		
	China Imports from World (\$ Million)	China Imports from USA (\$ Million)	U.S. Market Share	China Imports from World (\$ Million)	China Imports from USA (\$ Million)	U.S. Market Share
2011	16,551	2,854	17.2%	212,411	47,168	22.2%
2012	20,014	3,068	15.3%	241,088	57,576	23.9%
2013	25,378	3,158	12.4%	256,075	54,277	21.2%

Source: Global Trade Atlas

In 2013, China also created a new free-trade zone in Shanghai. The intention is to make Shanghai the international trade and financial rival to Tokyo, Hong Kong, and Singapore. The zone will go beyond trade liberalization to embrace investment and financial services, including free convertibility of the RMB. According to China's General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), they will also attach great importance to the building of the Shanghai free trade zone and will call upon the city's quality inspection departments to render their support by introducing relevant facilitation measures in three respects, namely, "easy entry and exit," "simplification of procedures," and "innovative control."

B. Overview of Chinese HRI Sector

In 2013, China's food service industry saw slightly slower value sales growth. On the one hand, the slowdown in economic growth in China impacted the expansion of food service industry. Consumers remained cautious about their spending as a result of the ever-rising cost of living and food prices. Meanwhile, food safety scandals continued to be exposed in public. Hence some consumers preferred to reduce their dining-out frequency, leading to a slowdown in value sales growth in the food service industry. Besides, the government policy of reducing public funds on entertainment continued to impact on high-end restaurants in 2013, which also slowed down the food service industry's sales growth.

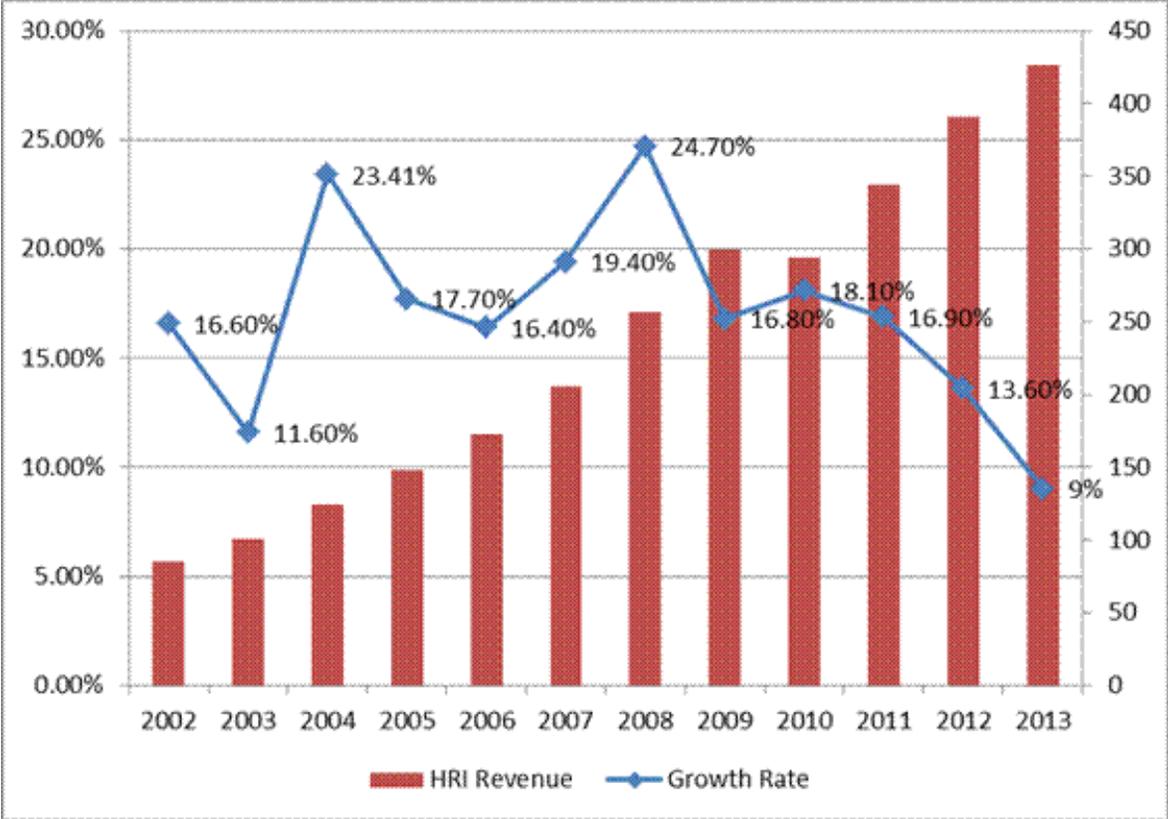
China's Hotel Restaurant and Institutional Sector recorded \$426.15 billion of sales revenues in 2013, a nine percent increase from previous year. However, it's the lowest growth rate in the past 20 some years, and the growth rate was 4.6 percent lower than previous year.

From the end of 2012, the Chinese Central Government issued relevant policies, such as restrictions on expenditure on official banquets as well as anti-waste and anti-extravagance measures. High-end restaurants have been negatively impacted by the new measures and they are facing huge losses. In 2013, high-end hotels and restaurants got \$136.35 billion sales revenues, the first time in the past decade for a negative growth rate (-1.8%). It was the very first time in the past decade that high-end hotels and restaurants to see a down turn. Many high-value food ingredients, raw materials and alcoholic beverages sales have dropped significantly since then.

In order to turn around the situation, more high-end restaurants adjusted their strategy and started to move towards to mass-market positioning through the launch of mid-priced dishes, while still maintaining a refined service. Besides, many high-end restaurants introduced new products, which mainly targeted mass consumers. Some food service operators are looking into various methods to

stimulate sales, including opening new restaurants under sub-brands with more focus market segment groups, developing group dining business (such as family gathering, birthday party, wedding banquets, etc.), offering personalized service, longer service hours, theme promotions, etc.

China Catering Industry Annual Revenues & Growth Rate (2002-2013)



Source: China Statistic Yearbook 2013 & China Catering Association

Note: Starting from 2010, the Chinese State Statistics Bureau has adjusted the scale of HRI sector revenue from Hotel & Restaurant Sector retail revenue to Catering Industry revenue.

Guangdong province continues to take the lead in terms of revenue of the Hotel Restaurant and Institutional (HRI) industry, reached \$43.55 billion in 2013, followed by Shandong and Jiangsu province. While most of the provinces still saw some increase in the HRI sector, the growth rate had slowed down quite a bit.

China HRI Industry Revenue & Growth Rate in 2013		
Province	HRI Revenue (\$ billion)	Growth Rate (%)
Guangdong	43.55	7.6
Shandong	37.30	10.7
Jiangsu	32.70	11.0
Hubei	28.76	15.7
Henan	26.71	13.8
Sichuan	25.29	10.1
Zhejiang	23.15	11.1
Hunan	21.11	15.5
Liaoning	20.30	10.8
Fujian	15.53	9.5
Beijing	13.05	-5.0
Heilongjiang	12.60	9.2
Anhui	11.66	12.1
Tianjin	11.03	13.5
Chongqing	10.04	12.2
Yunnan	8.63	9.4
Shan'xi	8.25	4.4
Shanghai	8.08	1.0
Shanxi	7.83	13.3
Xinjiang	4.50	13.7
Guizhou	3.46	6.0
Hainan	2.39	11.3
Ningxia	1.34	9.3
Gansu	0.57	-6.5
Qinghai	0.44	7.0
Nationwide	426.15	9.0
Source: China Catering Association		

The Top 100 Catering Companies saw even larger decrease on their growth. In 2003, the Top 100 Catering Companies generated \$31.85 billion sales revenues, 5.7% increase from the previous year. Among all sub-sectors, Quick Service Restaurant (QSR), Hot Pot Restaurant and Formal Chinese Restaurant accounted for 85.9% of total revenues of the Top 100 Catering Companies. In terms of growth rate, Hot Pot restaurant, Western style restaurant and Group Catering Company recorded the top three positions; while hotels dropped 8.0%.

2013 Top 100 Catering Companies by Sub-Sectors			
	Number of Top 100 Catering Company	Percentage of Top 100 revenues (%)	Growth Rate (%)
Quick Service Restaurant	20	38.3	1.0
Hot Pot Restaurant	30	25.4	11.2
Chinese Style Restaurant	35	22.2	3.0
Western Style Restaurant	5	8.5	19.0
Group Catering Company	7	4.4	13.7
Recreational Restaurant	2	0.8	-0.3
Hotel Restaurant	1	0.4	-8.0
Source: China Catering Association			

While these top 100 catering companies headquarter in 22 provinces, most of the companies scatter in Beijing, Chongqing, and Zhejiang province. However, the companies headquarter in Shanghai take the largest share of revenues, as a result of the largest Quick Service Restaurant chain, Yum Brands, headquarter in Shanghai.

2013 Top 100 Catering Companies by Region			
Ranking	Region	Number of Companies	2013 Percentage of Sales Revenues of Top 100 Catering Companies (%)
1	Shanghai	5	29.6
2	Beijing	23	15.3
3	Chongqing	14	13.7
4	Zhejiang	12	7.2
5	Tianjin	1	4.3
6	Guangdong	6	4.1
7	Inner Mongolia	3	4.0
8	Sichuan	4	3.4
9	Jiangsu	6	3.3
10	Fujian	4	2.8
Source: China Catering Association			

There is no doubt that 2013 was the toughest year for the HRI industry. The Central Government's anti-luxury and anti-waste policies have great impact, while hotels and Chinese style restaurants saw the greatest down turn in the past two decades. Almost all leading catering companies saw decrease in net profits, and some even closed a couple outlets with poor performances.

According to a recent survey by Unilever Food Solutions, over 85% of Chinese consumers eat out at least once a week. White collar workers contribute most to breakfast and lunch consumption, while family reunions and socializing with friends are strong consumption forces for dinner. In addition, there is a growing demand among Chinese consumers for exotic dishes and culinary fusions alongside improving living standards and higher disposable incomes.

2013 Public Listed Catering Company Profit Margin			
Ranking	Company	2013 Net Profit Rate (%)	Growth Rate (%)
1	Yums China	15.4	-2.7
2	Dao Xiang	6.3	-1.2
3	Quan Ju De	3.9	-1.4
4	Ajisen Ramen	10.2	4.8
5	Xiao Nan Guo	0.2	-4.9
6	Xiang Cun Ji	3.9	-3.4
7	Tang Gong	4.1	-2.6
8	Xiang E Qing	-70.4	-78.2
9	Xi'An Catering	2.8	0

Source: China Catering Association

Full-service restaurants remain the dominant channel for dining-out option in China. For traditional Chinese meals, capacious and comfortable seating facilitates relaxation and socializing. Fast food has become more popular due to ever faster modern lifestyles. The increasing number of urban professionals demanding fast and convenient meal options during the weekdays have contribute most to the development of fast food industry in China.

The first-tier cities, Beijing, Shanghai, Guangzhou and Shenzhen, remain the strongest centers of consumption and spending in the food service sector, with coffee shops and Cantonese cafeterias among the fastest growing segments.

For coffee shops, the atmosphere and free WIFI are drawing a growing number of Chinese consumers. For example, Starbucks has over 1,000 stores in China and is aiming for 1,500 stores by the end of 2015. Costa Coffee opened its first store in 2008, and is now operating more than 350 stores. McDonald's modified its business strategy in China and brought in McCafe in 2010, now operating about 700 McCafe corners in Mainland China. Other coffee chains, including Korean Coffee Bean & Tea Leaf, Coffee Bene and Hong Kong Pacific Coffee have also speed up their plans to expand in China.

Joining their western counterparts, Cantonese cafeterias are also gaining popularity. These Cantonese style cafeterias offer a mixed Chinese and Western menu and operate differently from the traditional Chinese restaurants. Most of them are open 10 am to 10 pm, providing twelve hour services, and do not close in the afternoon for a break. Some cafeterias even stay open all day long and serve tea-breaks and midnight snacks. They offer exotic beverages, snack foods and light meals, and at the same time, provide a-la carte menus and services at affordable prices.

Growing internet usage opens additional HRI opportunities by giving restaurants a new way to reach different prospects, such as e-menus, e-ordering, on-line reservation and e-payment. Group purchases of catering began in 2010 and have become prevalent, largely by allowing consumers to experience

high-end restaurants normally beyond their budget. It is likely more catering operators will attempt to employ discount for group purchases as a new marketing tactic rather than using a traditional thematic advertisement to attract potential customers. Food service operators have offered a variety of dish combinations with discounted prices, and consumers may purchase them with their preferred e-commerce platforms. Currently, there are many group purchase and B-to-C buying websites, such as Dianping.com, Meituan.com, Nuomi.com, etc.

E-commerce has shown its great impact on the HRI sector, especially on the restaurant business. According to a consumer report released by a leading E-commerce platform, on-line group purchase and e-coupon are getting very popular among the well-heeled consumers. On-line group purchase is most popular among Shanghai consumers, followed by Beijing, Shenzhen and Guangzhou. While consumers in emerging markets, such as Changsha, Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Qingdao, Shenyang, Suzhou, Tianjin, Xi'an, Xiamen, and Zhengzhou are catching up quickly. Over 60 percent of consumers incline to use their smartphones to browse for on-line discounted information as well as to use e-payments. Thus, the consumers will more prefer those restaurants with free WIFI service.

To explore more market opportunities, some food service providers sell their take-away dishes through the e-commerce platforms, which achieve good returns. For example, Jinbaiwan sold over \$5 million take-away dishes through internet in 2013, equivalent to the annual revenue of one of its 2,000 square meters outlet.

Food safety is always the center piece for consumers. The food safety scandals have increased consumer awareness about food safety and origin of products. These developments could potentially benefit imported food and beverage products, as imported products generally enjoy good reputation for high quality and product standards.

The Chinese government strengthens the supervision role on food safety. Within the recent revision for public comments on Food Safety Law, the government has proposed a higher penalty for those violating the law, as well as the establishment of a mandatory National Food Safety Responsibility Insurance.

To help the HRI industry overcome the operation difficulties, some organizations and local governments adopted favorable policies, such as lower bank transaction fees and reduced payable tax.

The health and wellness concept emerged against a background of higher living standards and growing disposable income, which further stimulated Chinese consumers' willingness to pursue healthier food choices. More and more consumers are aware of the negative impact of excessive sugar, high fat and high calorie intakes. All these factors have pushed the food service providers engage in different ways to better cater to the needs.

Regional Diversity

The food service industry in China varies across the regions. Culinary styles differ widely by city, which necessitates regionally tailored product marketing strategies and effort. China has eight

officially recognized cuisines as follows: Anhui, Fujian, Guangdong (Cantonese), Hunan, Jiangsu, Sichuan (Chuan), Shandong, and Zhejiang. In Northern China, noodles, dumplings and pancakes are common. Cantonese cuisine is considered to be the finest of China's regional cuisines because of its fresh and varied ingredients. Sichuan cuisine is known for its spicy dishes, including "Hot Pot." Chinese cuisine around Shanghai is best known for slow cooking and the more frequent use of soy sauce, sugar and other seasonings.

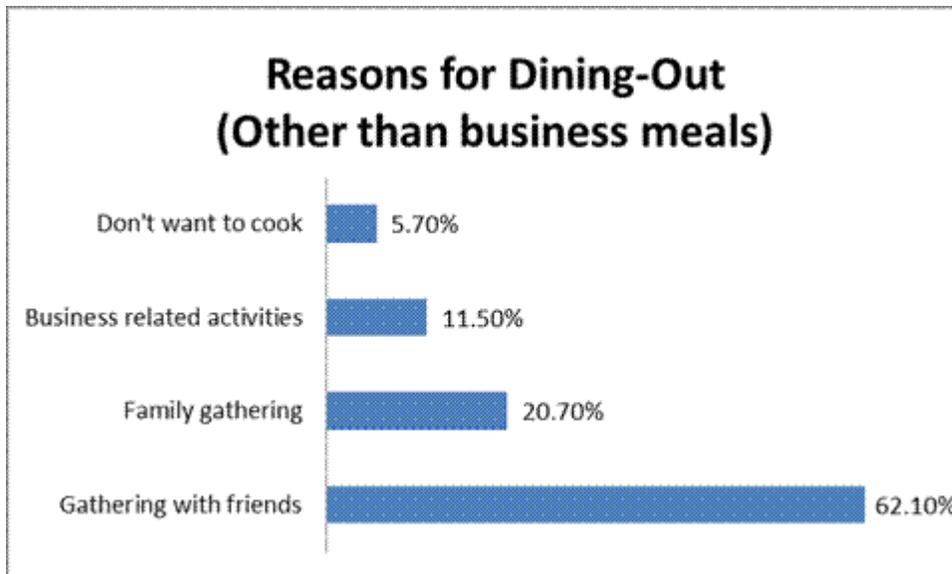
What and How Are We Eating

China is one of the world's largest producers of meat, eggs, aquatic products, grain, oilseeds, fruits, and vegetables. As wealth increases and consumption patterns change, traditional supplies of food are increasingly unable to meet evolving consumer demands in major cities. As people travel internationally and domestically, they also bring their culinary traditions with them across regions in China and from overseas. Consumers in major cities are demanding better tasting, stronger flavored and more authentic food. Health-conscious consumers are willing to spend more on products that can deliver health benefits, fight aging process or are seen as safer.



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

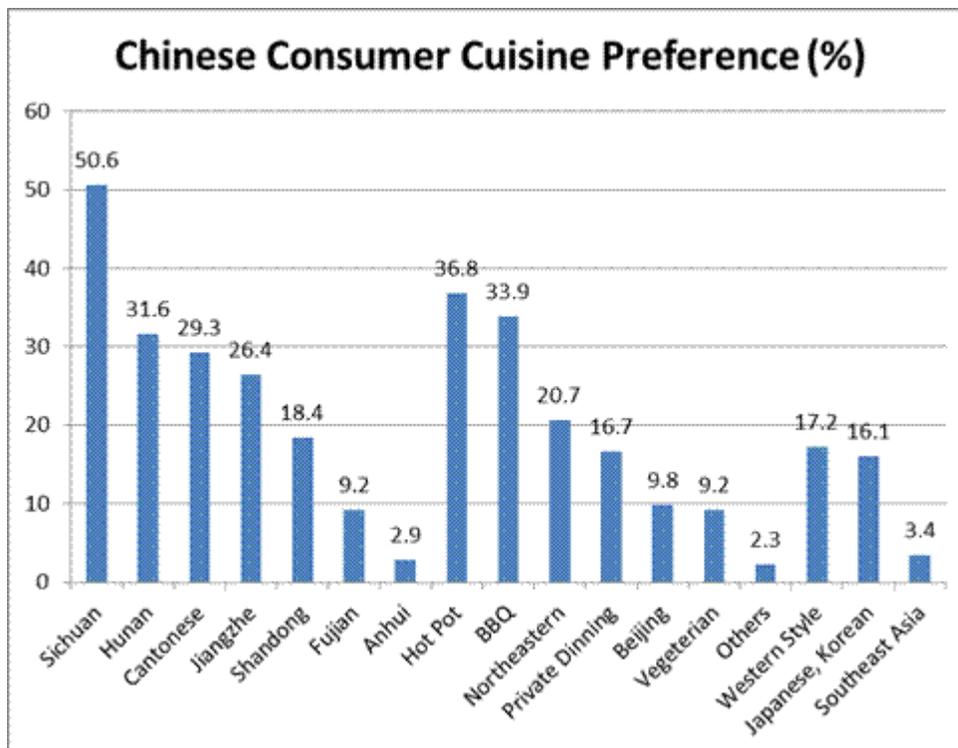
As disposable incomes rise, the younger generation and their families prefer to celebrate holidays and personal milestones by going out to eat in restaurants or hotels. While time savings from eating out is important, many Chinese view dining out as a way to establish and maintain close personal and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



Source: China Catering Association

The government's efforts to lower tariffs on imported food also made such items more accessible to Chinese consumers. There is increasing demand for western food in major Chinese cities. The preference for international food brands is becoming more obvious among Chinese urban consumers, who have grown increasingly aware of food safety issues. The perceived safety and quality guarantees of imported food attract Chinese customers. The growing Chinese economy and the residents' increasing purchasing power are among the causes of the increasing consumption of Western food products.

According to a recent national survey by China Catering Association, spicy food is the most popular taste among all Chinese consumers, and Sichuan cuisine is the most favored choice for dining out. For specialty cuisines, hot pot and BBQ are most welcomed, while Western style cuisine, Japanese and Korean foods are also preferred by consumers.



Source: China Catering Association

International Influx

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

These overseas visitors working and traveling in China continue to significantly influence the HRI food service market by their demands for health and good tasting foods – many of which will be sourced overseas. International visitors will also inspire and influence the tastes of the wealthy, as well as fashionable and cosmopolitan young Chinese. Demand for high quality food products that meet stringent food safety standards will also continue increasing because of international events. Events such as the 2008 Beijing Olympic Games, 2010 World Expo in Shanghai, 2011 Guangzhou Asian Games, and Shenzhen Universiade 2011, had largely increased demand for qualified food during the event, and the demand stayed well above earlier levels even after the Games ended.

Business Meals

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

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

However, since the end of 2012, the Chinese Government has ramped up efforts to suppress corruption and advocated frugality in government affairs. Chinese Central Government issued its new policy of government spending restrictions on dining and lodging. After this, it put forward relevant policies including restrictions on the expense of official banquets as well as “anti-waste” and “anti-extravagance” measures. The new measures had a significant impact on the foodservice and hotel industry in China, particularly high-end restaurants. Faced with the changes, some leading premium restaurants will seek to address the difficulties they face by transferring to a more mass-market positioning. Many high-value food ingredients, raw materials and alcoholic beverages sales have dropped significantly since then.

Weddings, Holidays and Domestic Travel

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

Chinese holidays were updated in 2008 adding a few traditional festivals to the official list including Qingming (Tomb Sweeping Holiday), Dragon Boat Festival and Mid-Autumn Festival. These restored holidays assist the HRI industry since they provide a boost to domestic travel and dining out. As Chinese society rapidly modernizes, traditional festivals are becoming more important to ordinary Chinese. This trend would likely increase spending. During holidays, food service establishments often offer special holiday menus to attract families, couples, and businesspeople. During traditional festivals such as Lunar New Year and Mid-Autumn (moon) Festival, reservations are often made 2 to 3 months in advance in stand-alone restaurants as well as hotels.

To encourage domestic tourism, the government has been upgrading travel-related infrastructure such as roads, seaports, airports, and tourist sites. Peak domestic travel time includes Chinese New Year and October 1st National Day Holiday. As China continues to open, develop, and grow, urban living standards continue to improve, and create many new HRI sector opportunities. Chinese are increasingly able to afford domestic travel. Rising incomes mean that every year more Chinese join a growing middle-class that can afford to travel. As China’s economy grows, business travel is also on the upswing, creating increased demand for travel accommodations. In 2013, over 3.2 billion tourists made domestic travels, which created \$437.94 billion expenditures.

China’s Tourism Industry		
Year	Tourists (Billion)	Revenue (\$ Billion)
2013	3.26	437.94
2012	2.96	378.44
2011	2.64	321.76
2010	2.1	209.66
2009	1.9	169.73

Source: China Statistical Yearbook 2014

Food Safety Concerns

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

In an effort to improve the food safety situation in China, the Chinese government enacted a new Food Safety Law on June 1, 2009. The Food Safety Law governs all imported foodstuffs, food additives, food containers, food packaging materials and food-related tools and equipment. The government is undergoing a public comment on the revision of Food Safety Law, which delivers the signal that the government will strengthen its supervision on food safety issues. Three significant issues related to HRI industry including 1) Higher penalty on illegal use of unapproved additives (adjust from the original 5 to 10 times penalty of revenues to 15 to 30 times penalty); 2) the on-line food trading platform will have associated responsibilities when a food safety issue occurred. The on-line food trading platform will be responsible to pay back to the consumer upfront, and then collect the compensation from the seller; 3) to set up a mandatory national food safety responsibility insurance system, to ensure the affected consumers get timely compensation through the insurance system.



Food product health and safety scandals have served to increase consumer awareness about food safety and food origins. These developments could potentially be a boon for some food exporters since imported food and beverages, including wine, from the United States generally enjoy a good reputation for high quality and product safety standards.

Cold Chain

The lack of cold chain logistics is another impediment of China's food safety system. According to China Federation of Logistics & Purchasing, China needs 365,000 refrigerated trucks and five billion cubic feet of cold storage by 2017 to serve China's growing market with effective safety levels. At the same time, increasing demand from restaurants and hotels are expected to stimulate demand for cold chain services. This interest in a large improved cold chain has been led by international chains such as McDonalds and Yum Brands. Now that the government is also focused on the sector, investment is likely to be very substantial in the years to come.

New Trend

On-line shopping is gaining in popularity in China, and holds promise as a potential avenue to increase sales across most sectors. Restaurants have begun to adopt new technology such as e-menu (menu on an iPad), e-ordering, on-line reservation and ordering, etc. China becomes the second largest market for internet retailing and online spending. According to Euromonitor, global internet retailing value is projected to expand by 15.3% in real terms annually in 2013 to reach US\$601 billion. Tmall (www.tmall.com), one of the largest e-commerce company in China, created an annual "double 11" promotion day. On November 11, everything sold on Tmall website will be 50 percent off or more. During the "double 11" promotion in 2013, Tmall generated sales of \$9.52 billion in just one day, which increased 65% from a year ago. The sales value in 2014 even jumped to \$10.62 billion. Other big e-commerce companies including JingDong (www.jd.com), Yihaodian (www.yihaodian.com), SuNing (www.suning.com), and Amazon (www.amazon.cn) also launched similar promotions around the same period of time.

There is no doubt that social media is the fastest growing platform for communication among consumers of all ages, genders and cultures. Social media is how people can interact online, hear and be heard, More importantly it's the medium with which consumers interacting directly with the products and brands that they love. To cope with this trend, more food service providers leverage the online platforms or smart phone apps as marketing tools. These include restaurant searches via positioning, on-line table reservation, on-line pre-ordering and on-line consumer feedbacks, which offer diversified experiences to consumers.

Some food service operators cooperate with group purchase websites, such as Dianping.com, Meituan.com and Lashou.com, to offer discount e-coupons. It has become a prevailing marketing strategy to attract young and new customers.

Consumer demands in major cities are growing and evolving. Especially in first-tier cities, such as Beijing, Shanghai, Guangzhou and Shenzhen, eating patterns are becoming more flexible and informal, particularly among young and affluent consumers. Twenty-four hour restaurants and coffee shops offering light meals and snacks are emerging in response to the fast pace of city life. Coffee

shops, Cantonese cafeterias and bakery shops serving deli foods are gaining popularity in China. Some convenience chain stores also get involved in the luncheon service market.

Demand is growing for healthy foods with special product attributes and healthy aspects such as high antioxidant and fiber content. Health-conscious consumers are willing to pay more for products that may deliver convincing health benefits.

Home delivery services grew in popularity and importance among young Chinese consumers. Fast-paced lifestyles left urban dwellers with less time to cook from scratch on a daily basis, especially during the weekdays. Thus, these consumers need quick and easy meal time solutions that are affordable and hassle free. Special occasions, such as Spring Festival and Mid-Autumn Festival, also create demand on home delivery services, while consumers can avoid the crowd and enjoy preferred meals in private. Home delivery services cater to this demand.

Franchising remains the key operating model for majority of food service operators in China, which can help the company to expand rapidly. It’s prevalent among traditional Chinese hot pot restaurants, cafes and street stalls like milk tea shops. However, how to maintain the quality, as well as product and safety control remain the biggest challenges facing by franchisors.

Soft drinks such as carbonates, fruit juice and herbal tea are most popular beverages in restaurants, especially among women and children. Tea continues to outperform coffee as the preferred hot drink during eating out occasions; while coffee is often ordered in cafes or specialist coffee shops. Beer is the most popular alcoholic drinks, due to its lower alcohol levels and consumer-friendly prices. Wine and craft beer are also catching up among young and well-heeled consumers.

North China Market

In the North China region, Beijing spends the most on food and dining out. Cities like Qingdao in Shandong province, Huhhot in Inner Mongolia, and Xi’an in Shaanxi province are leading cities in each of the provinces for foodservice industry.

Chart 1: Per Capita Annual Urban Household Disposable Income and Food Expenditures in 2013 for Provinces at a Glance:

	Disposable Income			Food					
				Total (RMB)			Dining Out (RMB)		
	2012	2013	% increase	2012	2013	% increase	2012	2013	% increase
Beijing	36469	40321	11%	7535	8170	8%	2032	2207	9%
Gansu	17157	18965	11%	4602	5163	12%	978	-	
Hebei	20543	22580	10%	4211	4405	5%	711	-	
Henan	20443	22398	10%	4607	4914	7%	1110	-	
Inner	23150	25497	10%	5463	6118	12%	1253	-	

Mongolia									
Ningxia	19831	21833	10%	4769	4895	3%	1223	-	
Qinghai	17566	19498	11%	4667	4777	2%	893	-	
Shaanxi	20734	22858	10%	5551	6076	9%	1577	-	
Shandong	25755	28264	10%	5201	5626	8%	1041	-	
Shanxi	20412	22456	10%	3856	3677	-5%	732	-	
Tianjin	29626	32294	9%	7344	7943	8%	1881	-	
Xinjiang	17921	19874	11%	5239	5324	2%	1123	-	

Government Anti-Corruption Campaign

When the central government decided to crack down on corruption starting late in 2012, many foodservice businesses dropped dramatically. Hotels and restaurants in Beijing were particularly hurt because of the focus on government agencies, most of which are headquartered in the capital. The anti-corruption campaign not only affected the gift market including high-value food and beverages, but also hotels and restaurant whose major customers are government officials. Lavish government banquets are banned and government-funded receptions and meals at hotels and restaurants, while not outright banned, face difficult approval processes.

Hotels

Hotel operators have claimed business has declined in particular for large banquets and buffets. As a result, purchase of imported foods or high-quality food materials have decreased. For five-star hotels, they have to maintain or cut down food costs, while maintaining quality menu offering for guests. Consequently, hotel F&B managers more carefully match purchases to estimated numbers of dinner guests to avoid waste. High-value products such as beef and seafood will be cooked to order even at buffet restaurant to save costs.

For hotels that are below 5-stars, for certain products that are not in the must-purchase list, F&B managers have the flexibility to cut those products or to find lower-cost substitutes.

As a result, exporters with new products should expect challenges to market entry, at least in the near future.

Restaurant Operations

Restaurants are seeking ways to continue to attract customers in this more austere government-spending environment. For example, according to the Beijing Canying Association, famous Shanghai-style restaurant chain, Xiaonanguo, closed 8 outlets in 2013 nationwide, which affected more than 5.5million RMB of the chain's overall revenue. Jing Ya, a chain restaurant headquartered in Shandong province, famous for its luxury seafood and banquets, has re-organized itself from a luxury restaurant chain to add hot pot restaurant operations to cater to middle-class consumers. The average cost per guest has dropped from at least 500RMB to about 200RMB to attract more

customers. A final example, Dadong Roast Duck, a famous restaurant chain based in Beijing, has opened Xiao Dadong, (meaning Little Dadong) offering a reduced-price menu.

The Ups and Downs

Importers claim dairy products sales, including UHT milk, cheese, sauces and cooking ingredients, are growing steadily. Pork and selected seafood products including scallops, lobsters have mostly maintained year-on-year sales.

Over the past year, food importers who carry ice-cream and fruit juice say their business has decreased about 33% for hotels and restaurants in Beijing and Tianjin. For other cities such as Qingdao, reductions are even steeper, causing importers to discontinue some products.

Chain or Quick-Service Food

The famous fast food giant KFC announced in October, that total revenue for the first 3 quarters of 2014 dropped 14%, and Pizza Hut decreased 11%. These results are probably due in part to a widely reported July food safety issue. Friday's has 8 restaurants in China with 6 in Beijing and 1 each in Shanghai and Tianjin. December 1, 2014, Friday's closed its landmark restaurant near Chang'an Avenue in Beijing, bringing its total number of restaurants down to 7 in China.

Ready-to-cook, portioned, powdered, and frozen foods have opportunities in the quick service sector.

On-Line Resources

Consumers ages 18-40 will often check on restaurant ratings before going to a new restaurant, or when selecting new places to dine out, using a website like www.dianping.com. It not only provides ratings, but also provides discount and special group purchase rate for customers to pre-purchase before going to restaurants. So customers have choices for meals and opportunities to compare the best value restaurants.

Home Delivery and Catering Services

Home delivery is becoming more and more popular. In Beijing, for example, www.daojia.com.cn is commonly used. Their slogan clearly announces their mission: A website to bring your favorite restaurant food home. Customers can choose menus from different restaurants, and www.daojia.com.cn will deliver the food from restaurants to customers' homes.

Catering for small gatherings of 10-50 people is a relatively new sector in Beijing, mostly of interest to international companies and expatriates. Imported food may have opportunities however the market is still very small and products will more than likely go through a distributor and not directly to the caterer.

E-Commerce to Support Home Cooking Using High-Value Food Materials

E-commerce has made grocery shopping easy. Many people do not have time to do the daily grocery buying any more - in most families both husband and wife work. Instead, they buy on-line, and products are delivered to their home. Online purchasing not only saves time and energy, but also saves cost of transportation, and sometimes prices are better than in stores. Popular e-commerce websites for North China are: www.yihaodian.com; www.jd.com; www.sfbest.com; www.tmall.com; www.tuotuo.com; www.fruitday.com; and www.benlai.com.

E-commerce offers excellent sales opportunities for dairy, baby formula, snack foods, frozen products, nuts, dried fruits, meat, seafood, beverages, wine, and liquor.

C. Sub-sector Profiles

Hotels and Resorts

The World Tourism Organization (WTO) estimates by 2020 China will become the world's most popular destination. Partially spurred by major international events, many internationally-owned or managed hotel groups are actively growing in China. According to a research report by Knight Frank, "While China's hotel market has seen some straining signals in 2012 and 2013, particularly in first-tier cities' luxury segment, burgeoning domestic demand should improve longer-term operations with demographic advantages. Although most of the international hotels chains are located in the first tier markets like Shanghai, Beijing, Guangdong, Jiangsu, and Zhejiang, international hotels have been showing their market confidence with aggressive expansion plans in China, particularly in second, third-tier cities and top tourism destinations, with their huge development potential."

Major International Star Rated Hotel Chains in China (2013)			
Brand Name	Subsidiary Brands in China	Headquarters / China Headquarters	Number of Hotels in China
Intercontinental Hotel Group	<ul style="list-style-type: none">• Intercontinental Hotels & Resorts• Crown Plaza• Holiday Inn• Holiday Inn Express• Hotel Indigo	UK / Shanghai	169
Accor Hotels & Resorts	<ul style="list-style-type: none">• Sofitel• Pullman• Grand Mercure• Mgallery• Ibis	France / Shanghai	179
Cendant Corp.	<ul style="list-style-type: none">• Howard Johnson• Wyndham• Ramada• DaysInn• Super 8 Motel	USA / Beijing	110

Starwood Hotels & Resorts Worldwide	<ul style="list-style-type: none"> • Sheraton Hotels & Resorts • Westin • Le Meridien • Four Points • A Loft • W Hotels • St Regis • The Luxury Collection • Element 	USA / Shanghai	241
Marriot Hotel Group	<ul style="list-style-type: none"> • Renaissance • Marriott Hotels & Resorts • Courtyard Marriott • The Ritz-Carlton • JW Marriott 	USA / Hong Kong	78
Shangri-la Hotel	<ul style="list-style-type: none"> • Shangri-la Hotel • Traders Hotel 	Singapore / Shanghai	54
Kempinski Hoteliers	<ul style="list-style-type: none"> • Kempinski 	Germany / Beijing	20
Hyatt Hotels Corp.	<ul style="list-style-type: none"> • Hyatt Regency hotels • Grand Hyatt • Park Hyatt • Hyatt Hotels & Resorts • Andaz 	USA / Beijing	27
Carlson Hotels	<ul style="list-style-type: none"> • Radisson • Regent • ParkPlaza • ParkInn 	USA / Singapore	40
Hilton Hotels Corp.	<ul style="list-style-type: none"> • Hilton • Double Tree • Conrad • Hilton Garden Inn • Waldorf Astoria 	USA / Shanghai	59 (10 under-construction)
Four Seasons	<ul style="list-style-type: none"> • Four Seasons Hotels & Resorts 	Canada / Shanghai	8 (including HongKong and Macau)

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

Hotels usually prefer to purchase in bulk and often as a group, especially for chained hotels. Group purchasing or centrally controlled purchasing is often the rule. For example, a Shangri-la Hotel Group hotel needs to fill-in an online request form from their group purchasing center to place orders. Imported food products are often preferred by international hotels where multiple food service outlets on the premises cater to a diverse clientele. For international hotels, imported food products account for 15-20 percent of the total food purchases, making them some of the largest markets for imported food and beverage products.

In comparison, many domestically managed, private or state-owned hotels purchase far less imported food than international hotels. As market pressures force improvements and modernization, their demand may grow. Local hotel chains will be limited by cost consciousness and the fact that these hotels traditionally focus their food service on Chinese cuisine; however, some do offer western restaurants.

Restaurants

Geographically large and regionally diverse, China has very distinct local and regional food and flavor preferences. Among domestic consumer foodservice players, numerous well-known, distinctive local brands exist. However, only a handful of national brands that provide specialty foods enjoy widespread acceptance. Full-service restaurants are well-positioned in major cities such as Beijing, Shanghai, Guangzhou and Shenzhen. In addition to domestic food service players, increasing exposure and interest in foreign culture and travel means consumers are often interested in trying new Western-style foods. However, it is important to be aware of regional diversity when entering the China market – which in fact is a series of many markets instead of one. In general, supplies for non-chained establishments are sourced locally.

Stand Alone and Chain Restaurants

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

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

Beijing, Shanghai, Guangzhou and Shenzhen remain the strongest centers of consumption and spending in the food service sector, with coffee shops and Cantonese cafeterias among the fastest growing segments. For coffee shops, the atmosphere and free WIFI are drawing a growing number of Chinese consumers. For example, Starbucks now has over 1,100 stores in China and is aiming for 1,500 stores by the end of 2015. Costa Coffee opened its first store in 2008, and is now operating more than 350 stores. McDonald's modified its business strategy in China and brought in McCafe in 2010, now operating about 700 McCafe corners. Other coffee chains including Korean Coffee Bean & Tea Leaf, Coffee Bene and Hong Kong Pacific Coffee have also sped up their plans to expand in China.

Outlet Numbers of Chained Food Service Providers		
	Global Brand Owner	Number of Outlets
KFC	Yum! Brands Inc.	4,600
cnHLS	Hua Lai Shi Catering Management & Service Co., Ltd.	3,042
Quick	Brilliance Group Co., Ltd.	2,048
McDonald's	McDonald's Corp.	1,988
UBC Cafe	UBC Coffee Food Co., Ltd.	1,659
Kedi	Bright Food (Group) Co., Ltd.	1,376
Family Mart	Family Mart Co., Ltd.	1,240
Starbucks	Starbucks Corp.	1,140
Coco	CoCo International Co., Ltd.	1,087
7-Eleven	Seven & I Holdings Co. Ltd.	1,082
Pizza Hut	Yum! Brands Inc.	1,020
HD/Alldays	Bright Food (Group) Co., Ltd.	1,000
C Straits Cafe	Zhejiang Liangan Food Chain Co., Ltd.	700
McCafe	McDonald's Corp	688
Ajisen Ramen	Shigemitsu Industry Co., Ltd.	626
Xiao Wei Yang	Inner Mongolia Xiao Wei Yang Chained Food Service Co., Ltd.	620
Daniang Dumpling	Jiangsu Grand Mother Dumplings	610
Dairy Queen	International Dairy Queen Inc.	537
Qinma	Chongqing Qinma Catering Management Co., Ltd.	529
Dezhuang	Chongqing Dezhuang Group	510
Kungfu	Kungfu Catering Management Co., Ltd.	492
DIO	Suzhou Dio Food Service Management Co., Ltd.	490
Subway	Doctor's Associates Inc.	436
SPR Coffee	SPR Holding Co.	401
Xiabu Xiabu	Xiabu Xiabu Catering Management Co., Ltd.	400
Little Sheep	Yum! Brands Inc.	400
Tea Storm	Shanghai Xin Shang Food & Beverage Management Co., Ltd.	389
Lawson	Lawson Inc.	371
Yoshinoya	Yoshinoya Holdings Co., Ltd.	353
Others	Others	75,809
Total	Total	107,677

Source: Euromonitor International

Rising consumption, preferences for more dining options, attentive service and stylish ambience has given full service restaurants and cafés/bars a boost across much of China. The number of specialty coffee shops and cafés also continues to grow rapidly. In addition, the popularity of premium restaurants in Beijing, Shanghai, Guangzhou and Shenzhen illustrates increasing preference for dining options that provide more than just good food. Café and bar chains, international and domestic, have been able to offer consistency and quality of food sought by consumers, leading dynamic growth in consumer foodservice outlets in China. For example, Starbucks offers ambience, aroma and comforting background music. Wireless Internet access and comfortable seating encourage affluent clientele to leisurely enjoy their time while sipping coffee. Among young urban Chinese and

expatriates, it is fashionable to meet friends in cafés rather than quick service or other restaurants, with places like Starbucks are often quote as landmark or meeting point. Premium restaurants are another form of lifestyle consumption as diners enjoy delicious meals in lavish environments that may include designer lighting, an intimate atmosphere, and high level of personal service.

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

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

Joining their western counterparts, Cantonese cafeterias are also gaining popularity. These Cantonese style cafeterias offer a mixed Chinese and Western menu and operate differently from the traditional Chinese restaurants. Most of them are open 10:00am-10:00pm, providing twelve hour services, and do not close in the afternoon for a break. Some cafeterias even stay open all day long and serve tea-breaks and midnight snacks. They offer exotic beverages, snack foods and light meals, and at the same time, provide a-la carte menus and services at affordable prices.

Quick Service Restaurants (QSRs)

While fast food is often perceived as unhealthy by many consumers, it continues to enjoy significant growth in China. Although snack foods sold by street vendors have been around for centuries, this sector continues to decline in number given rising food sanitation-safety concerns. Longer working days in urban environments minus traditional leisurely lunch breaks have increased Chinese consumer interest in fast food, which is quick, hygienic, and inexpensive. Fast food sales values increased by 9 percent reaching \$12.1 billion in 2013, and more than 1.4 million fast food outlets were reported.

Both major Asian fast food players and Western-style QSR chains tend to intensify the competitive landscape. More multinational fast food restaurants integrated Chinese cultural elements to their recipes and menus to enlarge their consumer base. Yum continues to be the market leader with a market share of 13.4 percent and over 4,000 outlets in China.

Brand Shares of Chained Restaurant (% Value)					
Brand	Global Brand Owner	Business Type	2011	2012	2013
KFC	Yum! Brands Inc.	Quick Service Restaurant	16.2	16.8	13.4
McDonald’s	McDonald’s Corp	Quick Service Restaurant	6.1	6.3	6.7

Dicos	Ting Hsin International Group	Quick Service Restaurant	3.3	3.9	4.7
Pizza Hut	Yum! Brands Inc.	Quick Service Restaurant	3.0	3.5	3.9
Starbucks	Starbucks Corp	Coffee Shop	1.2	1.5	2.4
UBC Cafe	UBC Coffee Food Co., Ltd.	Coffee Shop	1.7	1.7	1.8
Xiao Wei Yang	Inner Mongolia Xiao Wei Yang Chained Food Service Co., Ltd.	Hot Pot Restaurant	1.6	1.8	1.7
cnHLS	Hua Lai Shi Catering Management & Service Co., Ltd.	Quick Service Restaurant	1.5	1.6	1.7
Ajisen Ramen	Shigemitsu Industry Co., Ltd.	Quick Service Restaurant	1.5	1.3	1.2
Little Sheep	Yum! Brands Inc.	Quick Service Restaurant	-	1.4	1.1
Quanjudu	China Quanjudu (Group) Co., Ltd.	Full-Service Restaurant	1.3	1.2	1.0
South Beauty	Beijing South Beauty Catering Co., Ltd.	Full-Service Restaurant	0.9	0.9	0.9
Taoranju	Chongqing Taoranju Catering Culture Co., Ltd.	Full-Service Restaurant	1.1	1.0	0.9
Dezhuang	Chongqing Dezhuang Group	Hot Pot Restaurant	1.2	1.0	0.9
Kungfu	Kungfu Catering Management Co., Ltd.	Quick Service Restaurant	0.9	0.7	0.8
Qinma	Chongqing Qinma Catering Management Co., Ltd.	Hot Pot Restaurant	0.7	0.7	0.6
Daniang Dumpling	Jiangsu Grand Mother Dumplings	Quick Service Restaurant	0.5	0.6	0.6
Donglaishun	Donglaishun Group	Hot Pot Restaurant	0.6	0.7	0.6
Xiabu Xiabu	Xiabu Xiabu Catering Management Co., Ltd.	Hot Pot Restaurant	0.5	0.5	0.6
C Straits Cafe	Zhejiang Liangan Food Chain Co., Ltd.	Coffee Shop	0.5	0.6	0.6
Babeila	Shanghai Babeila Yizhou Catering Management Co., Ltd.	Cantonese Cafeteria/Hot Pot/Western Style Full-Service Restaurant/Home Delivery	0.5	0.5	0.6
Chongqing Xiaotian	Chongqing Xiaotian Catering Group Co., Ltd.	Hot Pot Restaurant	0.8	0.6	0.6
Papa John's	Papa John's International Inc.	Quick Service Restaurant	0.5	0.5	0.5
McCafe	McDonald's Corp	Quick Service Restaurant	0.2	0.3	0.5
CSC	Country Style Cooking Restaurant Chain Co., Ltd.	Quick Service Restaurant	0.5	0.5	0.4
Costa Coffee	Whitbread Plc	Coffee Shop	0.3	0.3	0.4
Yoshinoya	Yoshinoya Holdings Co., Ltd.	Quick Service Restaurant	0.4	0.4	0.4
Burger King	Burger King Worldwide Inc.	Quick Service Restaurant	0.2	0.2	0.4
Xiangeqing	Beijing Xiangeqing Co., Ltd.	Full-Service Restaurant	0.7	0.6	0.4

Xiao Nan Guo Chinese Restaurant	WHM Group	Full-Service Restaurant	0.4	0.4	0.3
Little Sheep	Little Sheep Group Ltd.	Hot Pot Restaurant	1.6	-	-
Others	Others		50.0	48.2	49.2
Total	Total		100.0	100.0	100.0

Source: Euromonitor International

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

Nonetheless, Asian fast food offerings continue to dominate the market, with its sales value representing roughly 60 percent of the total. Competition among fast food operators has become increasingly fierce in some large urban cities, even some second-tier cities, and forced market leaders to expand into smaller cities and inland areas.

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

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

In July 2014, an undercover local TV reported that Shanghai Husi Food, part of the OSI Group, and a major supplier of many international food chains, allegedly sold expired meat to restaurants. The food quality controversy has hit mainly big international fast-food brands, including McDonald's and Yum Brands. According to news reports, McDonald's Asia outlets saw a 49% profit decrease."

Buyers such as Yum and McDonald's operate on huge volumes and demand very low prices from their suppliers, which compete fiercely for business on razor-thin margins. The Shanghai Husi scandal is just the tip of the problem.

The Shanghai Husi scandal exposes weaknesses in big foreign brands' ability to police their own supply chains and processing plants, whether in-house or through third-party auditors. Laws on food safety were incomplete and responsibility in enforcing them was unclear, making it difficult for regulators to do their jobs, said one industry insider.

The country's one-child policy is also increasingly influencing the dining out preferences of Chinese

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

Although price sensitivity limits the demand for imported food products, the QSRs are a good potential consumer of bulk products such as frozen potato products, meat, poultry, low priced seafood, other ingredients, condiments, and beverages.

Institutional Food Service

Traditionally only hospital, government, army, school, transportation and airline employees were served by institutional foodservice. However, with a more divided and professional job division, institutional foodservice has expanded into high-end office complexes and private companies. Majority institutional food service providers are small scale, while those international institutional catering groups still take a small share in the market.

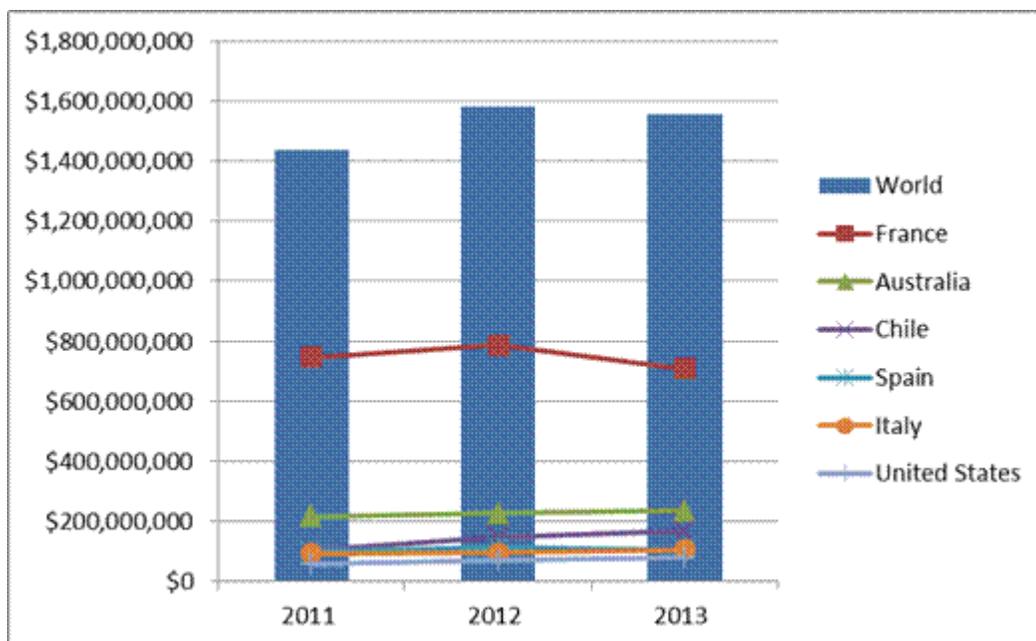
According to the China Catering Association, the institutional food service sector would reach \$216.7 billion revenues by 2015, or 30 to 40 percent of revenue of the entire HRI industry. However, the institutional food service sector is facing many challenges, such as lack of known brands and standardized operation procedures, food safety control and management, cost control, etc. The industry expects more consolidations would take place in near future.

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

China's Wine Market

The Chinese have a long history of consuming hard liquor (Bai Jiu), rice wines, and beer. Wine made from grapes is still a niche drink in this market. Imported fruit wines and wines made of grapes are evolving in recent years with local products taking much of the market share. French wines remain the most popular imported wine since Chinese consumers equate French wines with superior quality. Chilean and Australian wines are generally very price competitive.

China Wine Imports at a Glance



Source: World Trade Atlas

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

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

Major wine importers, distributors and retailers have first focused on educating consumers to build demand. Wine clubs are also very popular as people meet to learn more about wine pairing and build overall appreciation for wine. To some extent, wine purchases have also been employed as an investment strategy. However, the Central Government's new policy of government spending restrictions on dining and lodging have caused a sharp pullback from many expensive wines, especially French and Spanish wines. While Chinese imports in 2013 are relatively unchanged from 2012, low and mid-price range products appear not to have been largely impacted by the new policy.

China's Beer Market

China has been the world's largest beer producer and consumer for 12 years. In 2013, China made 51 billion liters (or approx. 51 million tons) of beer, increased by 4.6% from that of 2012. Since most of China's producers make mass-production beers with similar flavors, consumers are getting bored. Furthermore, Chinese beer per capita consumption has reached 34.2 liter, slightly over the world's per capita of 33 liter. Therefore, the market for domestic mass-production beer is becoming saturated.

In the meantime, an increased number of Chinese beer consumers, particular those middle class urban

residents, start preferring imported beers for better quality, various flavors and more ensured food safety. In 2013, China imported 182 million liters (or approx. 180,000 tons) of beer worth \$232 million, increased by 66% and 61% respectively from those of 2012. In terms of value, Germany is the leader with 59% of market share and Belgium is second with 7%; followed by Netherlands, Mexico and France, neck to neck around 4%. The U.S. ranks the 6th with 3.8%. In 2013, China purchased 4.8 million liters (or approx. 4,800 tons) of U.S. beer (including craft and non-craft beer) worth \$8.8 million, increased by 49% and 68% respectively.

Since 2013, China's economy has slowed down and Chinese government has strictly controlled spending by governmental organizations and state-owned enterprises. As a result, sales of Chinese liquor ("baijiu") and imported wine, which are often served at official or business banquets, have been greatly impacted. Nevertheless, imported beer has been remaining such a strong growth, which suggests its sales more rely on individual consumers' spending. Such consumer-driven growth is believed to be long-lasting and rise even faster when the economy warms up.

SECTION II: MARKET ENTRY

A. Market Structure

Target Population

While China's population grows relatively slowly, urbanization continues to create more than 20 million new consumers annually. Meanwhile, rising disposable incomes, particularly among white-collar workers, means urbanized residents can also afford more imported food and beverages on a regular basis. Increasingly, it is fashionable to sample international cuisine and wine, and many urban Chinese have both the desire and means to dine out regularly in upscale restaurants and bars. Chinese consumers actively pursue information through mobile social media, lifestyle media, TV and newspapers about imported food and food products, often seeking opportunities for new culinary experiences beyond traditional Chinese cuisine.

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

Distribution and Cold Chain Infrastructure

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

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

China's cold chain and logistic bottlenecks affect the food service industry. For instance, Yum! Brands own 18 large-scale distribution centers in China to serve 4,200 KFC, 800 Pizza Hut, and other Dong Fang Ji Bai, Xiao Fei Yang outlets.

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

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

Direct Imports

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

Major distribution options include:

- Full-service distributors.
- Third-party/ fourth-party Logistics. China has liberalized its distribution industry under WTO rules, and a small group of foreign-managed companies has developed in ports and free trade zones offering customs clearance, foreign exchange conversion, bonded warehousing and shipment. However, most do not specialize in the food business, so distributors or sales agents still need to sell, promote, and navigate many bureaucratic hoops such as licensing, labeling, and perhaps most importantly get paid from customers.
- Direct sales to end-users. This is limited to high volume customers like fast food and large hotel chains. Post suggests having local agents handle the paperwork and licensing issues to relieve the unexpected hassles, which can cause delays and risk the loss of whole containers of goods.

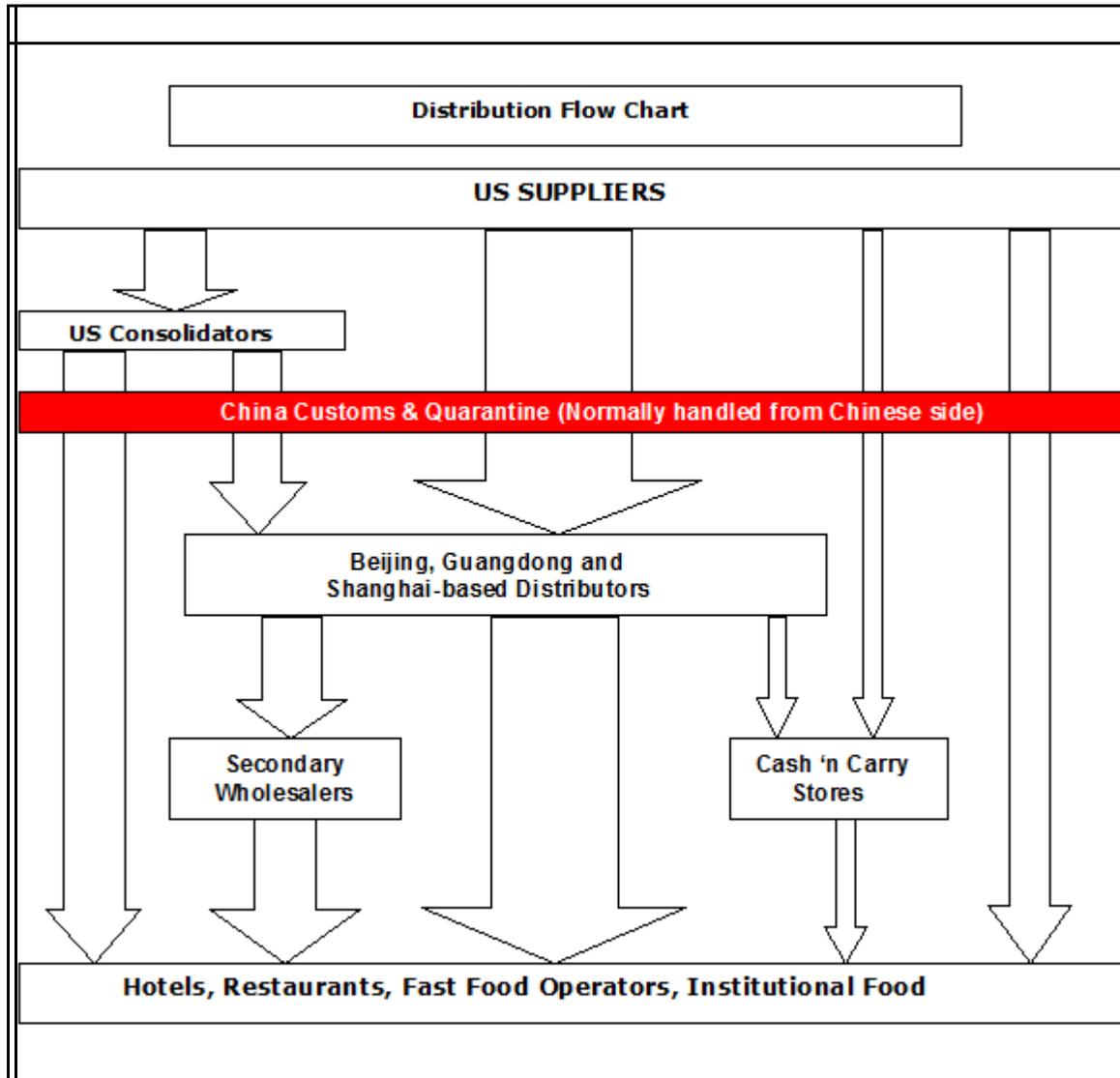
- U.S. consolidators fill orders for China-based distributors, and also fill direct orders for restaurants and hotels, so you still need to make sales in China. U.S. consolidator efficiency is considered a major advantage for U.S. exporters.
- Hong Kong distributors, who frequently make use of the gray channel. Many have a large network of offices or affiliates inside China, but basically provide the equivalent of 3rd party logistics services. The supplier still remains responsible for promotion, training and developing a market.
- Cash 'n Carry Outlets, such as Metro that target commercial customers like restaurateurs for purchase of bulk supplies – able to reach the restaurant food service trade directly.
- Online sales: National E-commerce giants such as www.jd.com, www.yihaodian.com, www.tmall.com, and www.amazon.cn provide a platform for importers to sell to end-users throughout China via their own logistics distribution chain or through a third-party logistics company. This has proven to be the fastest growing distribution channel to reach third and fourth tier city consumers where traditional distribution remains limited.

B. Entry Strategy

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

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

Marketing, Sales and Education



If there is one mantra that emerges from extensive discussions with HRI industry insiders, it is that the Chinese market needs to be educated from A-to-Z for most imported products. These means showing distributors how to handle and sell the product; developing recipes and demonstrating to chefs and food service staff how to use, prepare and serve it; launching promotional events to entice consumers with the resulting menu, and last but not least, persuasive articulation of why the product use makes commercial and economic sense in local terms.

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

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

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

Restaurateurs cite national or ethnic food fairs and promotions as an effective way to reach the ultimate consumer. Many restaurants look for opportunities to do special promotions, capturing customers on the lookout for a new dining experience. Most foodservice companies have a Weibo, Weixin or other social media accounts to help them promote their restaurant and release discount information, dish pictures, coupons and related news to their followers. It becomes a popular method of e-marketing for the foodservice industry.

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

Establishing the Supply Channel

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

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

It is crucial your importer or distributor is able to make payments in hard currency, or you will have

trouble collecting payment. The government has considered plans to make the Chinese Yuan (CNY), also called Renminbi (RMB), into a fully convertible currency, but it may be a number of years before such plans become a reality. Currently, Chinese companies need special Import & Export licenses to change RMB into U.S. Dollars. Also, RMB exchange rates began to fluctuate and continue to appreciate against the U.S. Dollar starting from 2009 – it is important to establish an agreed upon currency and exchange rate system or policy for any payments or costs.

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

Entry Tips

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

- Take time to study the market. Understand the exporting/importing process from start to finish. Partner with a reliable and capable distributor to execute all necessary importing documents and licenses.
- Having a great product is only the beginning. It is critical to understand the target market and prospective clients before you enter the market. If an international hotel, restaurant, fast food chain or air caterer is an existing client in the U.S.A, try to use that as an entry to the China branch.
- Be sure the products you carry are unique – if there is a similar domestic substitute or established foreign competitor, it may be difficult to compete on price/quality. An alternative strategy may be to enter the market by exploring geographic market segments not yet covered by the competition.
- Participate in USDA endorsed trade shows. Many suppliers get excellent market information by scheduling an initial visit to coincide with one of the many large international exhibitions held here in China, such as SIAL China, Food Ingredients China, Food & Hotel China (FHC), or China Fisheries and Seafood Expo. ATOs in Beijing, Chengdu, Guangzhou, Shanghai and Shenyang can all provide contact details for show organizers upon request as well as recruiting distributors or traders to the show for matchmaking meetings.

Trade Shows Featuring Food & Agricultural Products in HRI Sector			
Trade Show Name	2015 Dates	Location	Website
China Food and Drinks Fair (Tang Jiu Hui)	Mar 26 - 29	Chengdu	http://www.qgtjh.com/
Food Ingredients China	April 1 - 3	Shanghai	http://chinafoodadditives.com/d_e.htm

HOTELEX	Mar 30 - April 2 August 5 - 7	Shanghai Chengdu	http://www.hotelex.cn/
SIAL China	May 6 - 8	Shanghai	http://www.sialchina.com
Bakery China 2015	May 12 - 15	Shanghai	
China Fisheries & Seafood Expo	Nov 4 - 6	Qingdao	http://www.chinaseafoodexpo.com/
Food & Hotel China (FHC)	Nov 11 - 13	Shanghai	http://www.fhcchina.com/en/index.asp
	Nov 18 - 19	Chengdu	

- Be financially prepared. Consider all possible costs, such as: license, customs handling, promotion, education and training, freight, tariffs and VAT.
- Unless you are supplying one of the fast food chains or a hotel group, only selected products may ship large volumes. Most likely you won't be able to start with full container loads so consider waiving order minimums during the market entry phase.
- Different regions in China have unique and diverse dietary habits and tastes in food, just as they do in the United States. Always start in one region and conduct market tests before entering another. You may need to modify a product to make it conform to regional tastes and purchasing habits.
- Don't be too ambitious. Expand your business only after full confidence in operation in one location. One of the most common mistakes made in the China market is overly ambitious expansion without a solid foundation and loyal customers.
- Work to incorporate locally celebrated holidays, festivals and customs: Chinese New Year (Spring Festival), Mid-Autumn Festival, Qingming, Duanwu, May Day holiday and National Day holiday. Western holidays like Valentine's Day and Christmas are also increasingly celebrated here. International sporting events (Olympics, World Cup Soccer) are also very popular, and association with special events like weddings and business celebrations can provide good business opportunities.

SECTION III: COMPETITION

Imported food accounts for one-quarter of China's food and beverage sector. As such, the imported foods market in China is very competitive with suppliers from around the world battling for market share. Australia, Canada, New Zealand, South Africa and the European Union are most likely to supply products that compete with American products. These competitors provide heavy support for chefs, and the media including regular training in China and abroad.

Future food trends in China include:

1. Increased focus on healthy and nutritious products that deal with obesity and food safety;
2. Growing popularity of 'fusion' foods that combine western and Asian flavors;
3. Increased exposure to western cuisine via international restaurant and hotel chains;
4. Increased emphasis on inventory and cost management.

Imported U.S. food products have an excellent reputation for delivering consistent high-quality.

Chefs' exhibit strong loyalties to U.S. beef, despite its unavailability at present. French up-market cheeses and yogurt, Belgium chocolates, Australian lobsters and scallops, as well as Norwegian salmon are also considered premium quality.

Most imported products face at least some locally-manufactured, lower-priced competition, with only a few exceptions (e.g., olive oil). Significant competition comes from large corporations with local production (e.g., McCormick, DANONE, Rich's) for cost-saving or market access reasons. Aside from multiple food safety scandals that reach headlines, in general, locally-produced products are also improving in quality, so chefs and purchasing managers are increasingly faced with cost considerations when choosing imported or domestic supply. Nonetheless, China still has a long way to go. For example, China still imports around 70% of its potato fries, since domestic supply most years are inconsistent quality and economically uncompetitive. Also, due to China's increasing arable land and water resource limitations, most experts believe China will continue to fall further away from self-sufficiency.

Traditional advantages of locally-produced goods are also being mitigated as the Chinese economy develops and opens. As the RMB continues a slow appreciation against the U.S. dollar, this makes U.S. products more affordable for Chinese consumers. Also, as Chinese wages continue to increase, their local food manufacturing sector becomes relatively less attractive for investment. In reality, Chinese agribusinesses are more likely to continue seeking investment overseas, including in the United States to secure efficiently-produced, safe food sources.

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

Major Products, Market Shares, and Competitor Situations			
Product	Foreign Suppliers	Foreign Supplier Situation	Local Supplier Situation
Beef Imports \$1.33 bil	1. Australia, 56% 2. Uruguay, 22% 3. New Zealand, 12% 4. Canada, 6% 5. Argentina, 3%	BSE restrictions block U.S. market access.	China's beef industry is nascent and meat quality not generally acceptable for stand-alone use such as steaks.
Pork Imports \$2.62 bil	1. USA, 29% 2. Denmark, 16% 3. Germany, 16% 4. Canada, 11% 5. Spain, 8%	Port and inland infrastructure improvements allowing greater trade.	China's pork industry remains large with low production efficiency, poor consistency, and variable quality. However, the sector is consolidating; inter-provincial trade is increasing.
Poultry Imports \$1.01 bil	1. Brazil, 48% 2. USA, 42% 3. Argentina, 5% 4. Chile, 3% 5. Poland, 1%	AD/CVD duties impede U.S. poultry exports. Turkey products now account for a large share of U.S. imports.	China's poultry industry is developed however quantity of products is insufficient to satisfy the domestic market.
Fish and Seafood Imports \$5.73 bil	1. Russia, 22% 2. USA, 15% 3. Norway, 7% 4. Canada, 7% 5. New Zealand, 6%	A large portion of imports from Russia are processed for re-exporting and some for local consumption.	Chinese prefer live fishery products. Most local products are less processed than imported products.
Dairy (Milk & Cream) Imports \$5.34 bil	1. New Zealand, 62% 2. USA, 10% 3. France, 5% 4. Germany, 5% 5. Australia, 3%	New Zealand and Australia have aggressive suppliers, low costs, and advantages in shipping time. Chinese regulatory hurdles limit eligible U.S. supply.	China's dairy industry is growing very rapidly but still in an early stage of development. It produces milk and yogurt but doesn't really compete in cheeses or butters.
Dairy (Cheese) Imports \$231 mil	1. New Zealand, 40% 2. Australia, 23% 3. USA, 19% 4. France, 5% 5. Italy, 4%		
Wine Imports \$1.55 bil	1. France, 46% 2. Australia, 15% 3. Chile, 11% 4. Spain, 7% 5. Italy, 7% 6. USA, 5%	The French name is considered luxurious but hurting from 2013 austerity measures. Wines from Australia and Chile compete on price.	China's wine industry is evolving with a few good wines; however it may take decades to catch up with international market leaders.
Breakfast Cereals Imports \$75mil	1. USA, 23% 2. Malaysia, 19% 3. Thailand, 11% 4. Germany, 9% 5. S. Korea, 8%	Malay and Thai supplies are cost competitive. Thai strength tied to regional sourcing from large U.S. corporation.	China's cereal industry is evolving and growing very rapidly with more consumers seeking quick and nutritious breakfast options.
Fresh Fruit Imports \$3.42 bil	1. Thailand, 35%	Chile is counter-seasonal supplier of similar U.S. products. Southeast	Local products cannot compare with the quality, variety and taste of U.S.

	2. Chile, 18% 3. Vietnam, 16% 4. Philippines, 9% 5. USA, 7%	Asian fruit differs from U.S. product.	imported products. Counterfeit products threaten U.S. image.
Fruit + Vegetable Juice Imports \$231 mil	1. Brazil, 35% 2. Israel, 22% 3. USA, 9 % 4. Spain, 5% 5. Denmark, 4%	Brazil and Israel dominate the market.	Domestic products have fewer varieties while compared with imported products, but are competitive in some sectors.
Non-Alcoholic Beverages Imports \$182 mil	1. S. Korea, 27% 2. Taiwan, 20% 3. Thailand, 9% 4. Malaysia, 8% 5. France, 7% 6. USA, 6%	Products from nearby regions dominate the market, because of similar taste and consumer preference. Tea drinks are the most popular flavor.	Local products are strong in marketing and distribution channel.
Dried Fruits Imports \$221 mil	1. Thailand, 41% 2. Vietnam, 21% 3. USA, 15% 4. Philippines, 8% 5. Indonesia, 3%	Dried fruits from Southeast Asia differ from U.S. varieties.	Local products cannot compare with the quality, variety and taste of U.S. ones.
Frozen Potato Products Imports \$160 mil	1. USA, 79% 2. Canada, 8% 3. Netherlands, 5% 4. Belgium, 5% 5. Germany, 1%	U.S. products have higher price, but also better quality and diversified products. Lower currency rate of Canadian dollars have made Canadian products more competitive.	China is the world's largest potato producing country; however, only 10% of its production is processed. The country also has limited supply of potatoes, which are suitable for processing. Inadequate storage facilities also hinge further development.

Source: Global Trade Atlas 2014

SECTION IV: BEST PRODUCT PROSPECTS

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

U.S. beef has been banned for import in China since December 2003 as a result of BSE. Food service professionals in the HRI sector remain committed to using U.S. beef due to consistent and unparalleled quality, and note that it easily out-competes competitor suppliers on flavor and appearance. Salmon, from a variety of country suppliers, is a popular import item, used widely in Japanese kitchens. American lobster, particularly live lobster, generates much interest; however, the Canadians have promoted very hard with similar product but named as Canadian lobster.

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

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

Products in Market with Continued Good Potential	Products in Market with Unrealized Potential	Products with Market Access Barriers but with Good Potential
<ul style="list-style-type: none"> • Chicken paws • Offal • Frozen potatoes • Table grapes • Pork • Fishery products • Nuts • Dried fruit • Coffee • Fruit juices • Fresh fruit 	<ul style="list-style-type: none"> • Dairy products • Turkey and other poultry products • Wheat flour and pasta • Dehydrated potatoes • Chocolate • Sugar confectionary • Mixes and doughs • Breads, pastries, and cakes • Cookies, waffles, and wafers • Breakfast cereals • Vegetable oils • Alcoholic beverages • Water beverages • Sauces and condiments • Organic foods 	<ul style="list-style-type: none"> • Beef • Processed eggs • Rice • Fresh Vegetables • Berries

SECTION V: GENERAL STATISTICS

Chart I: Per Capita Annual Urban Household Disposable Income and Food Expenditures

	Disposable Income (RMB)			Food Expenditures (RMB)		
	2012	2013	%Δ	2012	2013	%Δ
National Average	24,565	26,955	9.73%	6,041	6,312	4.49%
ATO Beijing						
Beijing	36,469	40,321	10.56%	7,535	8,170	8.43%
Gansu	17,157	18,965	10.54%	4,602	5,163	12.19%
Hebei	20,543	22,580	9.92%	4,211	4,405	4.61%
Henan	20,443	22,398	9.56%	4,607	4,914	6.66%
Inner Mongolia	23,150	25,497	10.14%	5,463	6,118	11.99%
Ningxia	19,831	21,833	10.10%	4,769	4,895	2.64%
Qinghai	17,566	19,499	11.00%	4,667	4,777	2.36%
Shaanxi	20,734	22,858	10.24%	5,551	6,076	9.46%
Shandong	25,755	28,264	9.74%	5,201	5,626	8.17%
Shanxi	20,412	22,456	10.01%	3,856	3,677	-4.64%
Tianjin	29,626	32,294	9.01%	7,344	7,943	8.16%
Xinjiang	17,921	19,874	10.90%	5,239	5,324	1.62%
ATO Chengdu						
Chongqing	22,968	25,216	9.79%	6,870	7,245	5.46%
Guizhou	18,701	20,667	10.51%	4,993	4,915	-1.56%
Sichuan	20,307	22,368	10.15%	6,074	6,472	6.55%
Tibet	18,028	20,023	11.07%	5,518	5,889	6.72%
Yunnan	21,075	23,236	10.25%	5,468	5,741	4.99%
ATO Guangzhou						
Fujian	28,055	30,816	9.84%	7,317	7,425	1.48%
Guangdong	30,227	33,090	9.47%	8,258	8,857	7.25%
Guangxi	21,243	23,305	9.71%	5,553	5,841	5.19%
Hainan	20,918	22,929	9.61%	6,556	6,979	6.45%
Hunan	21,319	23,414	9.83%	5,442	5,584	2.61%
ATO Shanghai						
Anhui	21,024	23,114	9.94%	5,815	6,370	9.54%
Hubei	20,840	22,906	9.92%	5,838	6,259	7.21%
Jiangsu	29,677	32,538	9.64%	6,658	7,074	6.25%
Jiangxi	19,860	21,873	10.13%	5,072	5,221	2.94%
Shanghai	40,188	43,851	9.12%	9,656	9,823	1.73%
Zhejiang	34,550	37,851	9.55%	7,552	8,008	6.04%
ATO Shenyang						
Heilongjiang	17,760	19,597	10.34%	4,687	5,070	8.17%
Jilin	20,208	22,275	10.23%	4,635	4,658	0.50%
Liaoning	23,223	25,578	10.14%	5,809	5,804	-0.09%

Source: China Statistics Yearbook 2014

Chart II: China Consumer Expenditure on Hotels and Catering

China Consumer Expenditure on Hotels and Catering							
		By Region (US\$ Million)			Per Household (US\$)		
		2012	2013	%Δ	2012	2013	%Δ
	National Average	112,284.5	127,011.8	13.1%	259.9	289.4	11.4%
ATO Beijing							
	Beijing	3,611.2	4,179.1	15.7%	447.9	496.1	10.8%
	Gansu	1,357.2	1,519.0	11.9%	186.3	206.2	10.7%
	Hebei	3,161.1	3,533.4	11.8%	148.5	164.2	10.6%
	Henan	5,201.2	5,778.2	11.1%	194.8	215.4	10.6%
	Inner Mongolia	2,156.8	2,430.7	12.7%	244.6	270.5	10.6%
	Ningxia	547.6	624.5	14.0%	264.6	292.8	10.7%
	Qinghai	291.8	331.5	13.6%	174.4	193.2	10.8%
	Shaanxi	3,071.7	3,433.0	11.8%	270.7	299.3	10.6%
	Shandong	6,180.6	6,909.3	11.8%	196.6	217.7	10.7%
	Shanxi	1,790.6	2,014.2	12.5%	162.3	179.5	10.6%
	Tianjin	1,822.9	2,061.1	13.1%	440.8	488.8	10.9%
	Xinjiang	1,537.1	1,757.8	14.4%	208.3	230.6	10.7%
ATO Chengdu							
	Chongqing	2,717.9	3,036.5	11.7%	260.0	288.1	10.8%
	Guizhou	2,029.0	2,277.4	12.2%	183.8	203.6	10.8%
	Sichuan	5,534.1	6,182.6	11.7%	206.5	229.0	10.9%
	Tibet	134.8	152.8	13.4%	187.0	207.6	11.0%
	Yunnan	2,832.9	3,175.6	12.1%	218.0	241.7	10.9%
ATO Guangzhou							
	Fujian	3,314.4	3,722.3	12.3%	263.3	292.5	11.1%
	Guangdong	17,676.8	20,412.4	15.5%	506.4	562.5	11.1%
	Guangxi	2,990.8	3,364.5	12.5%	215.7	239.4	11.0%
	Hainan	794.4	909.7	14.5%	305.0	339.3	11.2%
	Hunan	4,205.8	4,680.9	11.3%	219.3	243.4	11.0%
ATO Shanghai							
	Anhui	3,632.0	4,084.9	12.5%	182.3	202.1	10.9%
	Hubei	3,267.3	3,639.6	11.4%	187.5	207.9	10.9%
	Jiansu	7,627.6	8,571.2	12.4%	289.4	321.1	11.0%
	Jiangxi	1,974.7	2,214.0	12.1%	163.1	181.1	11.0%
	Shanghai	5,535.3	6,388.2	15.4%	573.6	636.7	11.0%
	Zhejiang	9,100.6	10,383.1	14.1%	427.9	474.8	11.0%
ATO Shenyang							
	Heilongjiang	2,600.4	2,923.6	12.4%	190.7	211.1	10.7%
	Jilin	1,916.7	2,147.5	12.0%	203.7	225.4	10.7%
	Liaoning	3,669.2	4,123.3	12.4%	232.1	257.1	10.8%

Source: Euromonitor

SECTION VI: POST CONTACTS & OTHER RESOURCES

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

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Useful Chinese Government Links:

China Ministry of Agriculture

<http://english.agri.gov.cn/>

General Administration of Quality Supervision, Inspection and Quarantine of China

<http://english.aqsiq.gov.cn/>

China Customs Statistics

<http://www.chinacustomsstat.com/asp/1/English/index.htm>

China Food and Drug Administration

<http://eng.sfda.gov.cn/WS03/CL0755/>

China Ministry of Health

<http://www.moh.gov.cn/>

China State Administration for Industry and Commerce

<http://www.saic.gov.cn/english/index.html>

State Intellectual Property Office of China

<http://english.sipo.gov.cn/>