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FOOD PROCESSING SECTOR

2009 Update & Forecast for China's Food Processing Industry

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Report Highlights:

Over the past five years, China's food processing industry has grown at nearly 30 percent annually, with 2008 total gross output value expected to reach RMB four trillion (\$588 billion). Continuing economic development, expansion of trade into the emerging cities, increasing urbanization, interest in food safety, and increasing consumer interest in new foods are all expected to continue generating major opportunities for high quality U.S. food ingredients

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Executive Summary:

This annual report examines trends and prospects in China's food processing industry in 2009. The year 2009 is symbolic for China, because it marks the 30th anniversary of the country's reform process. While the country has been affected by the global financial downturn, China still managed to grow at nine percent in 2008. In addition, the value of foreign trade in 2008 reached \$1,218 trillion, up 27 percent from \$956 trillion in 2007. According to the World Bank, China is now the second largest economy in the world -- only the U.S. economy is bigger.

The food processing industry has played an important part in this economic miracle. In 2007, China's food sales revenue exceeded RMB three trillion (\$384 billion), 70 times the 1978 pre-reform level. In 2007, the number of large food processing companies grew to nearly 30,000 with fixed assets totaling RMB 344.8 billion (\$44.2 billion) with total food export and imports of \$32.3 billion and \$30.6 billion, respectively. If small processors are included, it is also believed that China has up to 500,000 food processing firms.

Despite 30 years of development, China's food processing industry is still immature, especially compared with developed countries. For example, its ratio of processed output value to agricultural production value is only 1:2. This is much lower than the 3:1 in developed countries. At the moment, relatively little value is added in China during processing because much of the production is still fairly basic and focused on primary activities such as milling and slaughter.

Growth in the food processing sector has averaged almost 30 percent from 2003 to 2007. Although growth will likely fall after 2008, it should stay in the double digits. Food processing has grown quickly partially because of rising demand for food products and because the sector requires fairly low investment and uses relatively unsophisticated technology. While this has resulted in a very open, competitive and dynamic industry, it has also contributed to the fragmentation of China's food market, low profit margins and occasional quality and safety problems.

In 2008, China was not been spared from the global economic downturn – although it was less impacted than other places. Reliable sources believe that China will not reach its earlier eight percent growth target. Instead, most put expected growth at six to seven percent. This relative slowdown has led to the closure of many small and mid-sized companies, declining FDI, and a reduction in customer visits to high end hotels and restaurants. To boost economic activity, the Chinese government has implemented a range of measures, including a RMB 4 trillion (\$588 billion) plan aimed at revitalizing ten core industries, including the food processing sector.

Fortunately, the food industry has been even less affected by the downturn than the economy as whole. Slowing but still rising disposable income and accelerating urbanization are continuously changing the Chinese diet away from the conventional fresh food and wet markets to the more western type packaged food and hyper market. Chinese are also

getting used to frequent dining-out and eating dairy foods while the young and white collars prefer frozen and convenient food. At the same time, young parents seek out high quality baby food and the elderly also seek healthier foods. At the same time, food safety has become a major concern for Chinese consumers because of the Sanlu melamine-contaminated infant milk powder scandal and other problems. Other trends such as ongoing urbanization, an aging population and other factors will also have a major influence on the market. For experienced U.S. exporters who prepare carefully, all of these trends provide ample opportunities for U.S. food ingredients.

Note: RMB is converted into U.S. dollars at prevailing rates in effect during data collection periods. In 2007, \$1 = 7.6 RMB and in 2008-2009, \$1 = 6.8 RMB.

Author Defined:

SECTION I. MARKET SUMMARY

- **Market Overview**

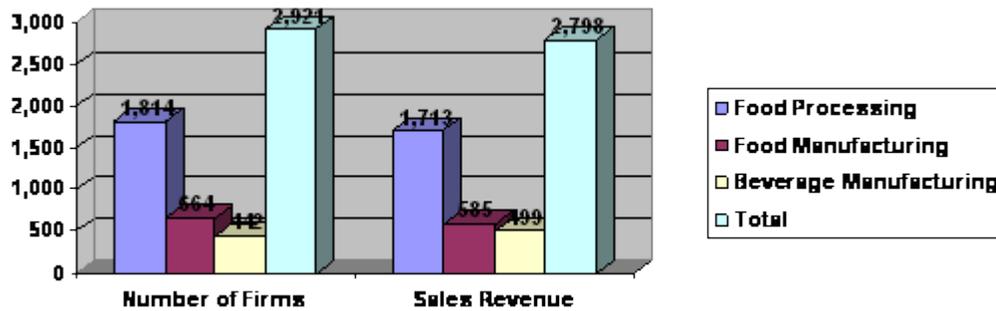
1.1.1. Number of firms and sales revenue

Despite rapid development over the last three decades, most of the Chinese food processing industry is concentrated on primary processing. According to Chinese official data, most firms still specialize in the primary processing of food products such as milling, animal slaughter and refining. The statistics separate industrial food production into three categories, including:

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

Figure 1: Food Processing Industry, Number of Firms & Sales Revenue, 2007

(Sales Revenue in RMB billion)



Source: China Statistical Yearbook, 2008

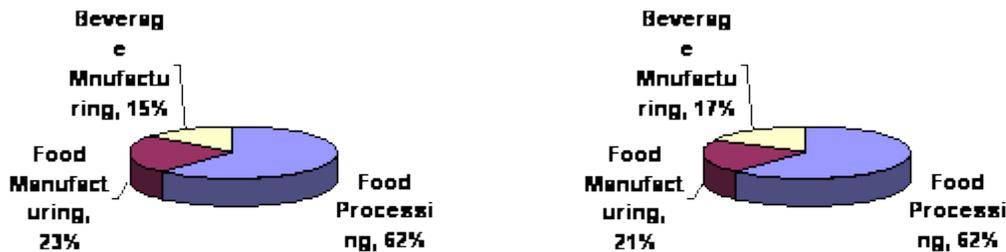
* Statistics are only available for firms with annual sales revenue in excess of RMB 5 million.

** 1 US. Dollar was equal to approximately 7.6 RMB in 2007`

With almost 30,000 major processors and sales worth RMB 2.8 trillion (\$368 billion), the data portray a large food processing industry in China, both in number of firms and sales revenue. However, since these data do not include those with annual sales revenue less than RMB 5 million (\$735,000), the real number of processors is likely much larger. While the 2006 China Statistical Yearbook estimated the total number of firms in the sector at 125,000, other sources put the total at between 450,000 to 500,000. In terms of value, the large food processors are believed to have around a 70 percent market share [1] , putting total industry value at around RMB 4 trillion (\$526 billion).

The industry is also very fragmented: The top 100 firms in China only accounted for less than 25 percent of total sales in 2006. Although consolidation is under way, major economies of scale are a long way off for much of the industry. This process will also be slowed by the dominance of regional firms, the undeveloped cold chain, and the fall-off in Foreign Direct Investment (FDI) which fell 15 percent from March 2008 to March 2009.

Figure 2: Number of Firms and Sales Revenues in Sectors in Percentages 2007



Source: China Statistical Yearbook, 2008

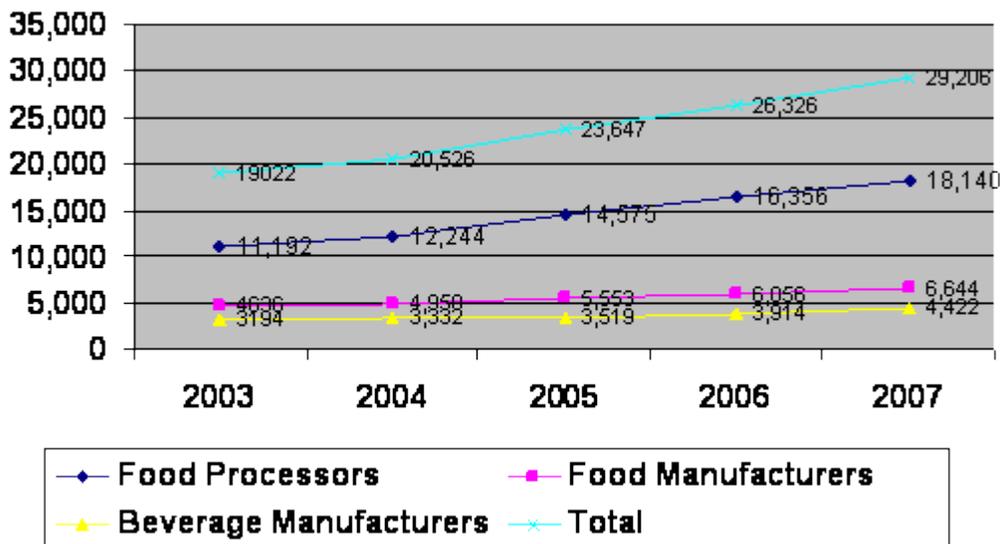
* Statistics are only available for firms with annual sales revenue in excess of RMB 5 million

Despite of its huge size, China's food processing is still focused on the primary processing of agricultural products, which accounts for 62 percent of the industry. The other sectors that include food and beverage manufacturing jointly account for only 38 percent. This figure is far lower than in developed countries and reveals the immaturity of China's food processing industry. On the other hand, the relatively undeveloped state of food processing can also create potential opportunities for U.S. exporters who can partner with emerging Chinese companies.

1.1.2. Market growth

The past few years have witnessed the most robust growth for China's food processing industry since China's reforms started over 30 years ago. For the last five years, the industry maintained an annual average growth rate of 11.32 percent. The primary food processing sector, the largest part of the industry, achieved an impressive growth rate of 12.83 percent, followed by food manufacturing with 9.41 percent and then beverage manufacturing at 8.47 percent. Although growth data on small firms is not available, it is believed to be tracking that of the primary food processors. Although the current economic crisis is expected to sharply reduce these increases, rising incomes and the accompanying move to better foods will likely keep growth at least half these levels in 2009 and beyond.

Figure 3: Growth of Numbers of Firms in Food Processing Sectors 2003 - 2007

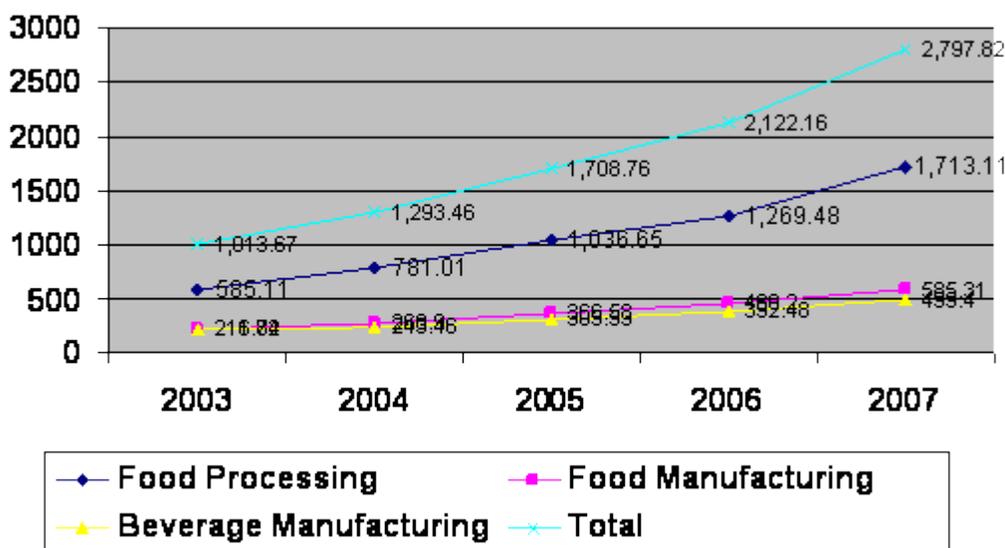


Source: China Statistical Yearbook, 2008

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

In the recent past, growth in the food processing sector was robust because of rising demand for processed food products and aid by the fact that primary processing requires fairly low investments and relatively unsophisticated technology. While this has resulted in a very open, competitive and dynamic industry, it has also contributed to the fragmentation of China's food market, low profit margins and occasional quality and safety problems. This dynamic is expected to continue since companies compete largely on price. However, in the immediate future, growth for small firms may go slow because of a higher entry bar set by the government's new Food Safety Law, effective from June 1st, 2009.

Figure 4: Growth of Sales Revenue in Food Processing Sectors 2003- 2007 (RMB100 million)



Source: China Statistical Yearbook, 2008

Compared with the number of firms, the growth of sales revenue is even more impressive. The 2003-2007 average annual growth was to 28.89 percent, far outpacing the growth in the number of firms. The primary food processing sector still leads among the three sectors, boasting a yearly average growth rate of 30.81 percent, followed by food manufacturing at 28.18 percent and beverage manufacturing at 23.93 percent.

While the 2008 data is not available yet, it was reported recently that the sales by end of

the third quarter of 2008 were over RMB 3 trillion (\$441 billion) – and that this would climb to RMB 4 trillion (\$588 billion) by end of 2008. Even if the financial crisis cuts the 2008 total below RMB 4 trillion, growth in 2008 is still expected to be around 30 percent from 2007. Based on the long-term trends in the food industry and China’s expected growth of six to seven percent, 2009 growth in food processing will likely fall is still expected to remain well into the double digits.

1.1.3. Individual sector size and growth

The Chinese food processing sector can also be examined based on products and ingredients. The table below illustrates the relative size of the sectors and how fast each has grown over the past five years. Except for the fresh food sector (including meats, fish and seafood, nuts and eggs, see table below) which experienced mild growth of 2.98 percent, all other major food sectors grew more than 10 percent -- with some even closing 20 percent. Growth in beer, oils/fats, juices and dairy processing were especially remarkable. Although most of these sectors are expected to keep growing, the dairy sector will likely face a contraction because of food safety issues. Although 2009 will likely be challenging for the dairy sector, tighter regulation, ongoing consolidation and the exit of the more disreputable companies will likely pave the way for recovery in 2010.

Figure 5: Sub Food Sector Market Sizes

(Value at RMB million at Current Prices, Volume at 1,000 tons)

Items	2004	2005	2006	2007	2008	% Avg. Annual Growth
Alcoholic drinks (Value)	216,923.1	238,946.2	265,418.1	304,085.6	346,584.3	12.43
• Beer	92,269.9	102,658.6	117,275.3	139,474.6	162,998.9	15.29
• Wine	22,697.4	24,321.6	26,391	30,491.2	34,489.9	11.03
Fresh food (Volume)	576,415.4	600,789.8	617,444.8	632,636.7	648,130.8	2.98
• Meat	73,911.3	79,095.1	82,525.8	84,926.1	88,086.4	4.48
• Fish and seafood	39,163.8	40,631.5	42,101.6	43,571.2	45,527.9	3.84
• Nuts	5,328.4	5,355.4	5,550.6	5,708.3	5,843.0	2.33
• Eggs	20,748.0	23,711.8	25,677.2	27,642.3	28,609.0	8.36
Health and wellness food and beverages (Value)	105,550.9	120,015.9	134,688.8	149,616.2	174,140.7	13.33
Health and wellness –	48,259.7	52,102.9	56,854.8	61,478.7	66,293.6	8.26

Nutritionals (Value)						
Packaged food (Value)	458,838.7	509,873.0	566,936.2	636,425.8	706,120.0	11.38
Dairy products (Value)	79,735.0	97,371.9	114,990.9	132,258.6	148,722.7	16.86
Oils and fats (Value)	25,039.3	30,177.8	36,540.9	43,819.1	51,562.4	19.79
Soft drinks (Value)	135,824.5	153,569.6	172,750.8	198,640.3	228,822.6	13.93
Fruit/vegetable juice (Value)	36,281.3	43,785.6	51,578.5	62,781.4	72,308.5	18.82

Sources: ©2009 Euromonitor International

Note: 2008 data is provisional and based on part-year estimates.

1.1.4. Imports vs. domestic inputs

Pushed by its rapid food consumption growth, China's demands for raw materials are increasing quickly. While China itself is a major agricultural producer, it is also one of the world's largest agricultural importers. The data show that despite increasing agricultural production over the past five years, China's imports continue to climb because China's rising food consumption has outpaced domestic supplies. In 2008, China's export of agricultural products reached \$40 billion, while imported \$58.6 billion. This is the first time in recent history that China's food imports exceeded exports. And it is very likely that China will remain a net food importer because of its limited production resources and high consumption growth. The effects on individual products vary. For example, import growth for commodities such as cereal and meat is generally below 5 percent while for other products such as dairy the average growth rate hit 23 percent (before the melamine crisis). In 2009, growth for many products should remain high – although lower than in the recent past.

Figure 6: Food Ingredients Imports vs. Domestic Supply 2003-2007

Items		2003	2004	2005	2006	2007	% Avg. Annual Growth
Cereals	Imports \$ mil	442.424	2,218.543	1,394.914	820.813	514.990	3.87
	Domestic 10,000 tones	37,428.7	41,157.2	42,776.0	45,099.2	45,632.4	5.08
Pork	Imports \$ mil	90.639	54.452	28.968	21.305	123.149	7.96
	Domestic	4,238.6	4,341.0	4,555.3	4,650.5	4,287.8	0.29

	10,000 tones						
Beef	Imports \$ mil	11.932	9.946	8.769	8.538	14.198	4.44
	Domestic 10,000 tones	542.5	560.4	568.1	576.7	613.4	3.12
Milk/Dairy products	Imports \$ mil	413,093.84	560,809.5	660,220.709	791,791.135	956,258.454	23.35
	Domestic 10,000 tones	1,848.6	2,368.4	2,864.8	3,302.5	3,633.4	18.40
Citrus	Imports \$ mil	47.930	48.452	44.629	54.512	54.772	3.39
	Domestic 10,000 tones	1,345.4	1,495.8	1,591.9	1,789.8	2,058.3	11.22
Grapes	Imports \$ mil	51.190	82.212	98.100	85.078	81.047	12.17
	Domestic 10,000 tones	517.6	567.5	579.4	627.1	669.7	6.65

Source: China Statistical Year Book 2008 and World Trade Atlas

1.1.5. Production & consumption forecasts

Based on currently available data and trends, China is likely to remain a major importer of many major food ingredients. For example, trends in dairy products and meats point to increasing Chinese imports from overseas.

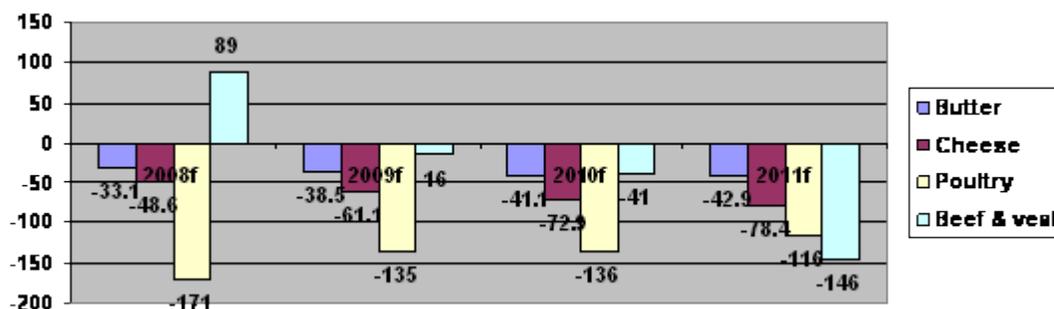
Figure 7: China Agricultural Production & Consumption Forecast (volume at 1,000 tonnes)

Items		2008 forecast	2009 forecast	2010 forecast	2011 forecast	% Avg. Annual Growth
Whole Milk Powder	Production	1,196.7	1,296.5	1,414.9	1,545.0	8.89
	Consumption	1,187.7	1,282.2	1,382.9	1,498.0	8.04
Butter	Production	99.4	99.9	100.9	103.3	1.29
	Consumption	132.6	138.4	142.0	146.3	3.33
Cheese	Production	249.5	252.3	253.3	259.5	1.32
	Consumption	294.5	313.4	326.2	337.9	4.69
Poultry	Production	11,115	11,385	11,652	12,000	2.59
	Consumption	11,286	11,520	11,788	12,117	2.40
Pork	Production	48,191	52,045	55,232	58,585	6.73
	Consumption	47,938	51,259	54,249	57,494	6.25
Beef & Veal	Production	8,058	8,381	8,882	9,410	5.31
	Consumption	7,969	8,397	8,924	9,556	6.24

Source: Business Monitor International

These trends are expected to increase net imports for all major meat and dairy products, except for poultry (where China can be generally competitive).

Figure 8: Forecast on China’s Negative Trade Balance on Some Products 2008-2011 (volume at 1,000 tones)



Source: Business Monitor International

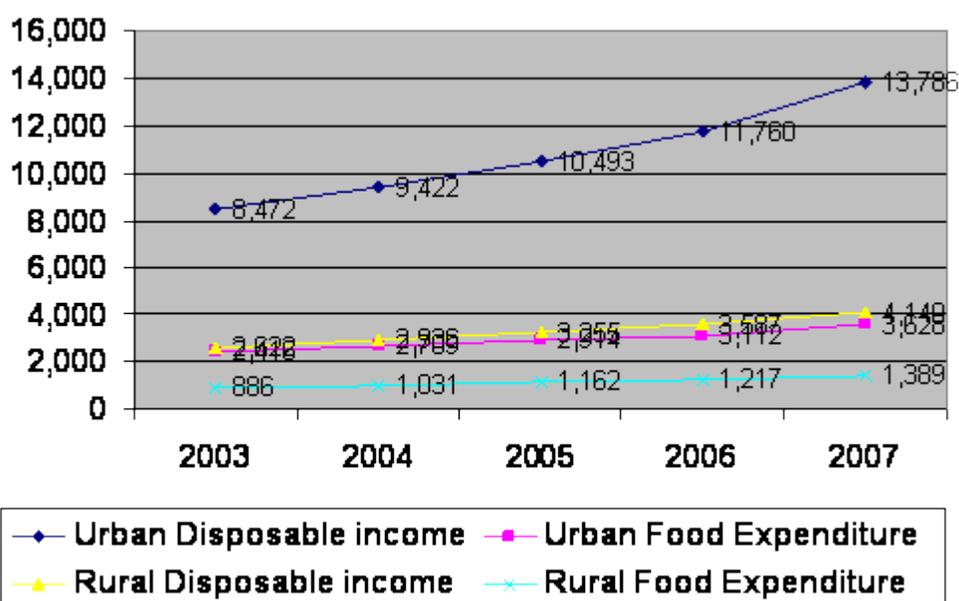
1.2. Market Drivers

The Chinese food market is driven by several factors – all of which are pushing up demand for me. Although the economic slowdown has had an impact, the increases in most kinds of consumption are expected to continue.

1.2.1. Increasing disposable income

The robust economic development over the last 30 years has greatly increased Chinese disposable income, fueling expansion of the food industry.

Figure 9: Per Capita Income and Food Expenditure in China 2003-2007 (RMB)



Source: China Statistical Yearbook, 2008

Most recently, disposable income growth over the past five years has increased more than ten percent annually. Urban income grew at 12.94 percent while rural grew at 12.10 percent. Meanwhile, food expenditures had high average annual growth rates of 10.70 percent for urban consumers and 11.90 percent in rural areas. Since urban consumers already have higher incomes and already consume more expensive and processed food products, their consumption growth rate is lower than in rural areas.

While the growth rates vary only slightly, it is worth noting that rural food expenditures are growing more rapidly but from a smaller base since they only are around 40 percent of urban totals. This is mainly because rural consumers' sensitivity to price and their preference for fresh food over processed food. Until rural areas get more income, the center of the processed food market still lies in the urban areas.

Over the next several years, continuing growth in disposable income is expected to keep fueling a consumer boom. The number of urban households earning more than US\$5,000 a year will likely grow annually by 24 percent, creating tens of millions of new consumers for high-value and imported food products. Around 5.8 million Chinese households already have "Western" levels of disposable income at US\$10,000 or more per year.

1.2.2. Urbanization

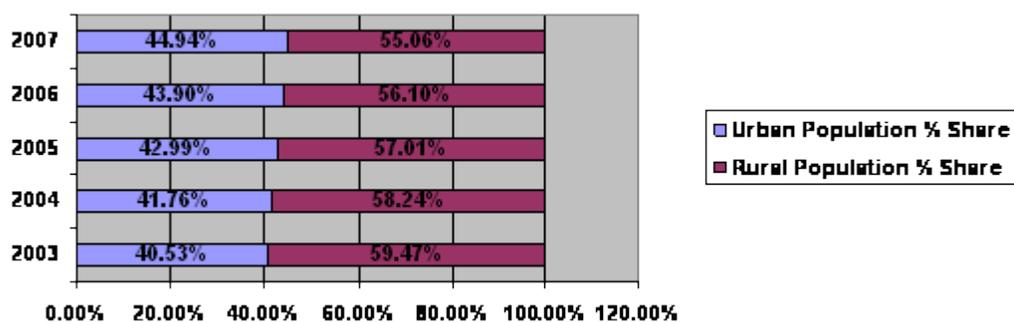
Chinese traditionally prefer fresh food and the wet market than processed food and super market. Reflecting this, rural people still mostly consume self-farmed crops, swine, poultry and eggs and only trade limited food when needed in wet markets. In urban areas, people are getting increasingly used to processed food and shopping in supermarkets. As urbanization moves forward, it is expected that the consumption of processed foods will increase.

The Chinese government has been encouraging urbanization for years, with a purpose of creating more jobs to accommodate more surplus rural laborers. As a result, rural population has been decreasing as urban population climbs. If current trends continue, the majority of Chinese will live in cities by 2013. This could have profound implications for Chinese demand for processed foods.

Figure 10: Urbanization Trends 2003-2007

(Millions)

	2003	2004	2005	2006	2007	% 4 Yr. Avg. Annual Growth
Total Population	1292.27	1299.88	1307.56	1314.48	1321.29	0.56
Urban	523.76	542.83	562.12	577.06	593.79	3.19
Rural	768.51	757.05	745.44	737.42	727.50	-1.40



Source: China Statistical Yearbook, 2008

The above figure shows a clear trend toward urbanization. While the total population increased by 0.56 percent (7 million) annually, the rural population has been shrinking by 1.4 percent or by about 10 million a year. At the same time, the urban population soaring

by 3.19 percent or around 15 to 20 million a year. Although the 2008-9 economic crisis saw a slight reversal of this trend because 20-40 million migrants lost their jobs, urbanization is expected to resume in the near future.

1.3. Consumer Trends

Consumption patterns in China are in rapid transition, particularly in the urban areas.

1.3.1. Safe food welcomed more than ever

Following a long list of food safety scandals, Chinese have never been so concerned about food safety. In 2007, a survey made by A.T. Kearney Inc showed food safety is very important for Chinese middle-class consumers, and 83 percent are willing to pay more for it. A more recent survey by the Horizon Group and Sohu News Centre also showed that food safety remains one of the biggest concerns for residents in China's major cities. These trends should boost the market for U.S. food ingredients.

1.3.2. Food away from home increasing

According to a July 2007 USDA survey, urban Chinese spent RMB 225 (\$33) per person per month on food away from home. This came to around 20 percent of their yearly disposable income on food away from home (This is based on urban disposable income of RMB13,786 in 2007, China Statistical Year Book 2008). Around 40 percent of food away from home is consumed in cafeterias, with another 20 percent in restaurants, about 10 percent in fast food venues, and another 10 percent at small food stands. Even though the financial crisis has changed this trend slightly, it is not expected to fundamentally reverse it.

1.3.3. Young generation are fans of convenient food and dining out

As in any other country, the generation aged from 20 to 40 wants to use their purchasing power to get a better lifestyle. This group is largely different from their parents and is influenced by the western lifestyle. As a result, they are usually fond of dining out and shopping. When eating at home, they prefer cooked, semi prepared and packaged foods. For them, food should be recreational, convenient, healthy, and ideally functional.

1.3.4. Yinfa industry, a promising market

While the young are an important market, China's population is also ageing rapidly. This is leading to the creation of an industry, the "Yinfa" sector, or The "Silver Hair" industry.

Figure 12: Population by Age 1995, 2007 and 2015 (% of total Population)

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

National statistics, UN, Euromonitor International

As of 1 January 2008

The table above shows that the population over the age of 60 has increased from 9.76 percent in 1995 to 13.02 percent in 2007, and is estimated to reach 16.93 percent by 2015. This change could be attributed to both increasing life expectancies and the One Child policy. Thanks to increasing life expectancies and much-improved health conditions, the number of elderly in China has been increasing rapidly. In 2007, this number reached 170 million, and is projected to hit over 230 million by 2015. The One Child Policy works in the opposite way by decreasing the size and proportion of children in the population.

The ever growing number of the old has triggered emergence of the Yinfa food sector. The old are quite concerned about their health, and see food as a part of the way to stay healthy. This is based on the traditional Chinese philosophy of "Shi Bu Sheng Yu Yao Bu", meaning "healthy food is superior to medicine". To this end, the old are consuming a large amount of functional and healthy food and/or vitamins and nutritional supplements plus traditional Chinese herbal medicines. These trends open the door to producers of high quality health food ingredients and nutritional supplements.

1.3.5. Geographic consumption differences

China is a huge country. This idea not only applies to its population size, but also its land area. The vastness of the country creates has created varied cultures and highly diversified eating and drinking preferences across the country. Previously, exporters would just leave the decision of where to sell their products to agents. But to be effective in the market, people need to understand the geographic eating preferences throughout China.

In general, China's market for consumption of food can be divided into five major regions: East, North, South, Southwest and Northwest. Provinces from the same region have relatively similar eating habits. This guide provides some rough ideas on where their products could generally go. The table below takes one representative province for example from each region to show the differences. For example, Beijing for the North, Shanghai for the East, Guangdong for the South, Chongqing for the Southwest, and Shaanxi for the Northwest.

Figure 11. Per Capita Annual Consumption Expenditure on Food Types of Urban Households by Region 2007 (2007 RMB)

	National Average	Beijing	Shanghai	Guangdong	Chongqing	Shaanxi
Starches & Tubers	26.19	43.10	38.91	20.09	33.43	33.66
Beans and Bean Products	43.43	51.95	74.97	36.73	43.00	45.58
Oil and Fats	117.32	132.95	117.58	134.69	158.81	112.11
Meat, Poultry and Processed products	703.27	819.14	907.66	1264.72	848.81	429.03
Eggs	83.83	99.47	89.05	65.41	85.78	68.58
Aquatic Products	243.78	208.82	669.24	489.13	135.13	68.76
Dried and Fresh melons and Fruits	272.24	489.57	450.44	306.04	228.85	234.79
Cake	74.01	173.87	170.70	90.34	57.60	83.32
Milk and	160.72	279.45	313.04	147.10	181.94	151.78

Processed Products						
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Source: China Statistical Yearbook 2008

The figures above in **Red** indicate the top consumption and the **Blue** ones imply the lowest consumption.

- Generally speaking, North and Northeast region prefers starches, tubers, eggs, dried and fresh melons and fruits.
- Eastern people are willing to spend more on beans and bean products, and particularly like aquatic and dairy products.
- The southern region, represented by Guangdong, takes lead in meat and poultry consumption, but is less interested in starches, tubers, beans, eggs and dairy products.
- Southwest people are prefer fat and oil, but stingy on melons and fruits and cake.
- Northwest, compared with other regions, is not keen on aquatic products and, is less interested in meat and oil and fats.

Note: Although the table does not correct for the varying purchasing power of the different regions, it does provide some rough idea of consumption patterns.

1.4. Analysis on Selected Sectors

1.4.1. Frozen processed food

Thanks to the ongoing improvement of cold chain infrastructure and the increasing ownership of refrigerators, the quick frozen products industry has been growing at over 20 percent since early 2000s. Increased family incomes and a reduction in the time available to cook among urban middle-class consumers are spurring more Chinese consumers to purchase frozen processed foods. According to Euromonitor, total sales of frozen processed food, including frozen processed red meat, poultry, seafood, vegetables, potatoes, and quick frozen read-to-eat products amounted to RMB 32.3 billion (\$4.8 billion) in 2008, a 12 percent increase over 2007. The largest sector is quick frozen processed food products, which are becoming increasingly varied. In addition to the traditional best sellers of frozen dumplings, sticky rice cakes, buns and frozen beef/pork/fish/shrimp balls, new varieties such as frozen pizza, frozen soup, frozen noodles and frozen desserts are gaining popularity among younger consumers in China.

Currently, 90 percent of quick frozen processed food products are consumed by families.

The major consumer segment is the working mothers and single white-collars in 1st tier and 2nd tier cities. The HRI is not as well developed because of weak distribution channels to the sector. However, higher margins in the food service sector are attracting major players interested in exploring market opportunities in this area and could be another opportunity for U.S. exporters.

According to the China Institute of Food Science and Technology, there were around 3,000 quick frozen processed food product manufacturers in China in 2008, with famous brands including Synear, Sanquan, Longfeng, Haibawang, Taixiang, Jiayuan, and Haodangjia. The manufacturers are mainly located in north China, and the top ten manufacturers holding more than 70 percent of the total market share in 2008. Among them the two biggest brands Synear and Sanquan, both located in Henan Province, took nearly 16 percent of the total market share.

The promising industry has been the target of heavy investment in the past few years. Large-scale meat processors including Shuanghui, Jinluo, Yurun, Zhongpin have also set up branch companies specializing in quick frozen processed food products. Local firms have been making considerable effort to attract investment for further expansion. Some successfully export their products to overseas markets such as Japan, Korea and the United States. Some are listed on the stock market. After Synear successfully listed on the Singapore Stock Exchange in 2006, Sanquan, another famous brand also based in Henan, was also listed on the Shenzhen Stock Exchange in February 2008. The 2008 Olympics even had an official dumpling supplier – Synear, which unveiled a series of advertising and marketing campaigns last year to strengthen its leading position in the industry.

Encouraged by the promising market, international food firms including Katokichi from Japan, and General Mills from the United States also came to China to set up their joint ventures or wholly-owned companies. General Mills invested \$13 million in Shanghai to produce frozen dumplings and wontons, targeting the upper tier of the market. Nowadays Wanchai Ferry, a famous brand owned by General Mills, has dominated the high-end market in Shanghai, Beijing and Guangzhou, and has racked up sales of nearly RMB 200 million (\$29 million) in 2008. Wanchai Ferry has occupied one third of the market in Shanghai and Beijing, and over 50 percent of the Guangzhou market share.

Unit prices of frozen processed products grew in 2008 due to rising cost of ingredients (edible oil, flour, pork) and operations (listing charges at retail outlet) as well as the

packaging materials. The new regulations effective in 2007 required that all frozen food products must be packaged, hence driving all “naked” frozen dumplings out of the retailers. This effectively improved the food safety of the quick frozen processed food products, but meanwhile resulted in a 20 percent increase in retail prices.

Although distribution problems caused by inefficient logistics and China’s relatively undeveloped cold chain infrastructure continue to constrain development of the sector, Post believes that continuing urbanization and increasing affluence of Chinese consumers leaves immense room for growth of the still-young quick frozen food industry in China. U.S. exporters could find targeting this sector very lucrative.

1.4.2. Baby food

Approximately 20 million babies are born in China every year. Statistics show that currently the population of infants aged between newborn and four years old is around 80 million. The 2008 Beijing Olympics stimulated many couples to have an “Olympics Baby” to coincide with this major historical event. This helped create another baby boom after the last 2007 “golden pig” baby boom. The family planning system imposed by the Chinese government that only allows most Chinese families only one child, ensures that more care and attention are lavished on those children.

Statistics show that nearly 80 percent of all working women are mothers in China, with children aged between zero and 16 years old. Increasingly, these working mothers are influencing the baby food industry. Working mothers help maintain the income of the household at higher levels, but also have less time to prepare fresh food for their children. With increased disposable incomes, young Chinese couples demand safer and better quality baby foods and are less sensitive to price.

According to Euromonitor, 2008 saw the market size of baby foods in China reach RMB 29.1 billion (\$4.3 billion), a 25.4 percent increase over 2007. Taken over time, the growth has been especially remarkable: The baby foods market in China has grown 191 percent since 2002. The spread of retail outlets, improved cold chain and distribution systems, and increased refrigerator ownership are contributing to the growing consumption of more diversified baby food products.

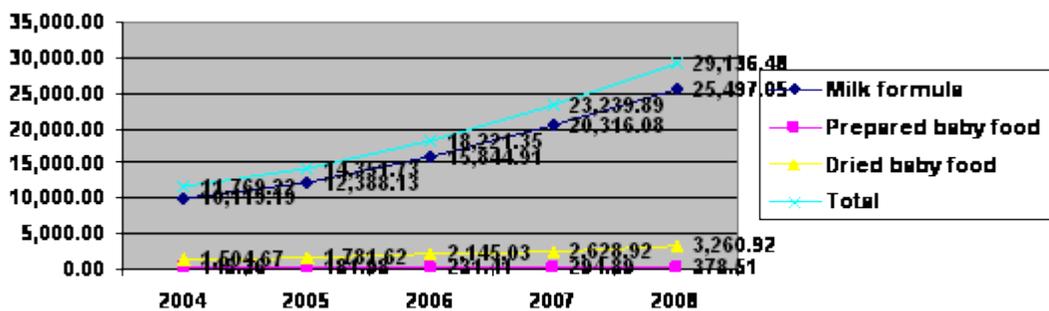
Spending per child is also on the rise, and consumers are able to afford the higher quality and more expensive products in the market. Unit prices of baby food increased in 2008 due to increasing global dairy ingredients prices as well as growing packaging materials

and transportation cost.

Over 70 percent of baby foods are distributed via supermarkets and hypermarkets. Internet sales are growing popular among those who are very busy or loyal to imported brands. On the other hand, the institutional market for baby food products is also growing, as nurseries and childcare institutions proliferate. Those with better food care are more attractive to busy working parents.

Figure 11: Sales of Baby Food by Subsector: Value 2003-2008

(RMB million)



Source: Euromonitor International

Newcomers to this industry, whether domestic or overseas companies, continually enter the market, driving the demand for many new and increasingly sophisticated products for babies. Infant formula milk powder, dried baby food (rice powders etc.) and prepared baby food (packaged foods in cans and jars) constitute the core of the baby food market.

Infant formula milk powder represented 87.5 percent of the total market value in China in 2008 and was its fastest growing sector. Although breastfeeding has been actively promoted by the government and health authorities, working mothers generally have to return to work after their maternity leave (normally 90-120 days) in urban areas and are often no longer able to breastfeed their babies. In addition, strong TV advertising campaigns by the infant formula manufacturers try to convince young parents that the added nutrients, like ARA, DHA, minerals and vitamins in their products are helpful in improving their babies' brain and eye development. Foreign brands such as Nestle, Wyeth, Similac Advance, Ausnutria, Dumex, Anmum, Mead Johnson, Primavita, Ausmeadow, and Good Health share 80-90 percent of the market. Yili from Inner Mongolia, Shengyuan from Qingdao and Wonder Sun from Heilongjiang are the biggest domestic brands.

Dried meals and packaged foods in cans continue growing, with flavored rice powders the most significant part of the dried meals category, and mixed vegetables, fruit, fish and meat are found in much more diversified flavors. Heinz and Nestle entered the China market in the 1980s and since then have built up high awareness among their target consumers. The domestic brand Beingmate was created in early 1990 and has more than 50 percent market share shared with Nestle and Heinz. Imported brands such as Gerber are dominating the high end market and have cultivated their own loyal consumers. Attracted by the great potential in China market, newcomers such as Eastwes and CEVO have also entered into this fierce competition.

The melamine scandal triggered by Sanlu, a leading domestic dairy brand whose baby formula powder was contaminated by melamine killed at least six infants and poisoned around 30,000, influenced the baby food market in several areas. One, it undermined consumers' confidence in domestic baby formula products and baby foods, resulting in drastic increase in demand for imported products. Many consumers, affluent or not so affluent, decided they were concerned more about safety instead of price – and turned to foreign brands. Two, new channels were developed by concerned parents for purchasing imported baby formula. As a result, online shopping on Tao Bao, purchasing via international airline crews, buying via friends or relatives traveling abroad, or traveling to Hong Kong and Macau to purchase baby formula, all undermined the sales of domestic brands.

Post estimates that in 2009 the baby food market will continue growing quickly in line with rising incomes, especially since the baby food market is not very price sensitive, especially in affluent areas like Shanghai and Beijing. Brand awareness, which is seen as a guarantee of quality and safety, will remain the key factor that influencing purchasing decisions. More international brands who enjoy good reputation on quality and safety will find it easier to break into the market. However, domestic baby formula brands are likely to eventually regain part of the market share with strengthened production standards and intensive promotion aimed at restoring consumer confidence. Exporters or producers of high quality baby food raw materials are highly recommended to tap this market.

1.4.3. Baking

Over the last ten years, China's baking sector has grown by 10 percent annually. This performance is relatively strong given China traditionally is not a bakery food consuming

country. Strong demand is being driven by both economic growth and changing consumer lifestyles. Western lifestyles in urban areas are pushing up demand for packaged/industrial bread in China, and whole-wheat sandwich and white bread are the two most popular varieties. Children, teenagers and white collar workers are the main consumer groups while others such as older family members are also influenced by them.

The recent global financial crisis and the slow growth of China's economy have had a minimal impact on the fast growing baking industry. Sales of expensive items have slowed but those at moderate or lower prices still sell well. To illustrate current trends, this section looks at southern China, which has China's most developed baking industry.

Baking business in wealthy southern China has kept growing well, especially in large cities in Guangdong and Fujian provinces. Industry sources believe that the industry in general has had two-digit percentage annual growth in recent years (official statistics were not available). Improving income levels drive consumers to become more lifestyle focused, and the faster pace of life is making ready-to-eat and prepared foods more accepted. Western style baked items, including breads, cakes, pastries and desserts, have all become very popular daily items.

The lucrative business has attracted both foreign and domestic bakery operators. While veteran chain stores, for example, *Maxim's Group* and *Queens Cake Shops* in Guangdong, enjoy consumer loyalty, thanks to their consistently high product quality. Meanwhile, upscale newcomers like Bread Talk, Yamazaki and even Starbucks Coffee and Circle K Convenient Stores are trying to gain market share by introducing innovative flavors, interesting product names, on-site baking, and eye-catching store images.

The bakery industry is highly fragmented because of product freshness requirements, uneven development of the industry, as well as subtle consumer taste differences in each province. Therefore, each area has its own dominant bakery chains. Meanwhile, high-end bakeries are eager to differentiate themselves from competitors, and a focus of their strategy is on product quality and innovation, which creates ample opportunities for high quality ingredients from the United States and other countries.

Imported ingredients and those made by foreign invested companies or joint ventures accounted for a substantial portion of the high valued items. Price remains a constraint that limits expansion of high quality ingredients in China. Setting up processing and manufacturing facilities in China is a way that many foreign companies employ to make

their products more price competitive.

Though traditional Chinese pastries such as moon cakes still dominate, consumers are becoming more sophisticated and demanding for greater varieties and quality of bakery products. Premium bakery chains continue playing a leading role in distribution, product innovation with fierce competition. Regional bakery chains are the most influential operators in respective territories, and there is no national chain yet.

The baking industry in southern China is made up of domestic and international ingredients makers, baking ingredients traders and numerous bakeries in various sizes. Major baked products makers can be categorized as industrial manufacturers, bakery chains, retail outlets as well as the upscale hotels. Baking industry in Guangdong and Fujian provinces are much better developed than in other southern China provinces.

A limited number of ingredients traders serve most of the market in respective provinces, e.g., Guangdong or Fujian. They consolidate ingredients from a number of ingredients producers who are located either in China or overseas, and sell to bakeries. Many of them supply a full range of ingredients, whereas some specialize in a certain category of ingredients, for instance, dairy ingredients, or oils and fat. With the support from ingredients producers, large ingredients traders often provide technical assistance to their bakery clients.

The industry is showing some trends:

- Bakery chains are grabbing more and more shares from individual bakery shops;
- Cold chain and frozen dough is becoming popular to ensure freshness
- The operation in the industry becomes more standardized and less labor intensive, due to the increasing labor cost and limited labor supply
- Food safety and quality becomes increasing concerns for the industry

The baking market in South China offers promising opportunities for U.S. bakery ingredient exporters. Making products with high quality ingredients is a way that high-end bakeries use to differentiate themselves from competitors, and thus create substantial demand for high quality ingredients. A wide range of imported baking ingredients, including wheat flour, dairy ingredients, dried nuts and fruits to fruit jam, filling and premixed flour, are frequently incorporated in baked goods by high-end bakeries, aiming to enhance nutrition and improve appearance with the consequence of bringing the products higher margins.

Large international baking ingredients makers, including *Rich's*, *Bake Mark*, *AB Mauri* and *Roquette* aggressively promote their products in this market. Some international giants have also established processing plants in China to better serve this huge market in the long term. Baking related associations from the US, France, Germany and Japan are actively developing their influence on the Chinese industry. Overall, the US is a competitive supplier in this market, given its high product quality, constant supply, as well as the versatility and diversity of products.

Traders tend to view wanting ingredients that fall into three categories:

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

Below summarizes the opportunities and constraints for U.S. ingredients in South China.

Opportunities:

- Booming baking industry in the region creates ample opportunities for high quality baking ingredients;
- Wealthy consumers in the region and westernized life style generate substantial demand for high quality baked products;
- Depreciated U.S. dollar against Chinese Remenbi makes U.S. ingredients more price competitive in this price sensitive market;
- As consumers are exposed to more western baked goods in their travels to other Asian countries and to North America and Europe, they are looking for similar items to be available locally.

Constraints:

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

Price is the determinant factor for bakery ingredient sales. Chinese ingredients are usually less expensive, and produced by numerous individual farmers or small farms. Compared

to Chinese ingredients, U.S. ones are commercially grown and processed, which enables more consistent quality, traceability and guaranteed food safety. However, prices are highly sensitive and constrain expansion of U.S. ingredients in this market.

As a result of cost concerns, most baking ingredients are domestically processed, by either foreign invested companies or domestic Chinese companies. But some ingredients, for example, cheese, butter, whipping cream, high quality fruit jam, rely on imports. High quality dried fruit and nuts are also competitive for upscale bakeries as they are eager to differentiate their products from their lower end competitors. High end bakeries insist on quality, despite the high prices.

However, higher prices compared to Chinese ingredients together with improved quality of domestically processed ingredients make the imported ingredients less competitive. U.S. bakery ingredients are available in China, but there is potential to expand penetration, promote sustained usage, and diversify selection. To further promote ingredients, U.S. exporters are suggested to continue working closely with ingredient traders, to educate users, as well as promote final products to consumers. Targets include bakery manufacturers, bakery chains and luxury hotels with internal bakeries in South China markets including Guangzhou, Shenzhen, Dongguan and Foshan in Guangdong province, as well as Fuzhou and Xiamen in Fujian province, where the baking industry is well capable to further feature U.S. ingredients.

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

1. Educate both bakers and consumers with the product;
2. Provide technical assistance to bakeries;
3. Work with Chinese bakers to develop recipes that suit the local palette and market;
4. Conduct in-store promotions to encourage purchases

Mooncakes, Chinese delicacies enjoyed by families in the Mid-Autumn festival season in mid-to-late September and the following National holidays, are the biggest revenue generators during a year for bakeries in China. Mooncake sales of \$1.6 billion in 2008 plus growing hunger for trendy new mooncakes with innovative fillings have created a niche market for U.S. ingredients. However, the chief challenges are price and ingredient

awareness. They need to be combined to maximize taste and profit. (Refer to GAIN CH7624 for more details on the China mooncake market.)

Conventional moon cakes in south China consist of very fine crusts of flour and different fillings: lotus seed puree with egg yolks, multiple nuts with pork, or red bean puree. In recent years, new varieties with different ingredients, e.g., fruit flavor (filling with fruit flavor winter melon puree), ice-cream and chocolate, have become popular, especially by young high income earners. Various high quality U.S. ingredients, e.g., cranberry and almonds, have also been creatively mixed with conventional lotus seed puree or multiple nuts in the moon cake filling.

In recent years, there have been significant surges of high value mooncakes, largely driven by increasing well-off new generation in cities. This group of consumers, mostly urban females between 18 to 32 years old, earning \$1,000 or more per month, believes food products with health benefits and willing to pay. Cranberries and blueberries have been the most successful ingredients promoted in the high end mooncake sector, due to the health benefits and successful promotion.

Taiwan could provide a window to future trends for China. On Taiwan, mooncakes have evolved from a seasonal item to an item that can increasingly be sold year round and even pitched to the tourist sector. There have been product lines developed using mooncake ingredients/fillings to create wedding cakes and tarts; all natural ingredient mooncakes using nuts, almond paste, figs; and ice cream mooncakes, using dried fruit such as cranberries, blueberries, raisings and almonds.

The problem with promoting high value ingredient or specialty mooncakes is justifying a production line that creates limited amounts or need further investment to modify the equipment or production line. Also, retailers tend to want to promote a line of mooncakes rather than focus on a specialty.

Crackers. Crackers and cookies have gained increasing popularity with Chinese consumers. Global food giants, including *Kraft*, *Danone* and *Nestle* have heavily invested in this market and share the market with leading domestic manufacturers as well as a large number of small and medium sized local manufacturers.

International and leading domestic brands dominate the mid- to upper market in urban regions, whereas small and medium sized domestic players sell most products in rural,

lower markets. Large cracker makers enjoy strong brand awareness, product development and comprehensive sales channel across the country. Famous international brands, including *Nabisco*, *Oreo*, *Ritz* and *Kjeldsens*, either produced in China or imported from other countries, are available in the market. Popular varieties include savory crackers, plain crackers, chocolate coated ones, sandwich crackers, filled crackers, wafers, butter cookies and creamy cookies. Small and medium sized companies, usually offering less sophisticated product lines and less well-known brand serve in limited regional or local markets. Many of the small and medium size manufacturers also make Chinese specialty cookies, e.g., almond cookies and peanut cookies which have long enjoyed popularity in the region.

Many production and operational personnel, including those working for international companies in China, need to learn more about quality and diverse characteristics of U.S. wheat which can enhance final products and reduce overall production costs. Without thorough understanding, manufacturers who want to shave costs are more likely to choose flour milled from less expensive wheat instead of the U.S. one. An approach is to educate clients to look at total production costs by using high quality flour, rather than just material cost of purchase. It is necessary to educate users with such knowledge, especially in the price-sensitive China market.

A threat for leading brands is that small and medium sized makers are likely to produce cheaper “copycat” version products. An example is *Popan*, a popular thin round cracker originally developed by the Singapore-invested *Garden*. This popular item with different flavors, e.g., spring onion or sesame, has been sold in the market for more than twenty years. Given the popularity of this product, many competitors copied the idea and sell similar products in the market, and thus dramatically grabbed the share from *Garden Popan* in the market.

1.4.4. Tree nuts

Falling import prices and strong domestic demand beefed up China’s imports of tree nuts in 2008. Imports of pistachios rose 54 percent from the previous year to 29,604 tons, shelled almonds up 171 percent to 2,615 tons, in shell almonds up 83 percent to 1,712 tons, in shell walnuts and pecans up 176 percent to 5,499 tons, hazel nuts up 56 percent to 1,805 tons, and in shell brazil nuts to 1,267 tons by 217 percent. The tariff reduction on pistachios from 10 to 5 percent also largely contributed to the leap of pistachio imports.

Sales of nut snacks in China reflect consumer preferences that vary by region and from nut to nut. In general, flavored nut snacks are most popular, while natural flavors are more popular among middle and upper income niches where consumers tend to associate natural with healthier and better quality. Compared south and east Chinese whose taste runs sweet, north and northeastern consumers prefer salty. Thus, nut processors have to adjust the percentage of salt and sugar in the brine used to flavor nut snacks. Flavor preference for pistachios, for example, seems universal across the country- either dunked in a sugar and salt brine, then roasted to get rid of the moisture, or natural flavor. As for pecans, creamy flavored is most preferred in the east while the five spice flavor is more popular in the rest of China. Hazel nuts are generally roasted only.

Pistachios. Non-bleached U.S. pistachios are gaining ground over previously dominant non-bleached ones in China. Compared to U.S. pistachios, Iranian ones, usually cheaper due to inferior quality, originally have darker shell color, and therefore have to be bleached prior to being sold. It dominated the market for years due to cheaper prices, and most Chinese consumers, wrongly equated the bleached color as a symbol of quality. U.S. pistachios, usually a natural ivory color, reentered the China market in 2007 with a strategy to differentiate themselves from their Iranian competitor by having non-bleached natural ivory shell color. Meanwhile, U.S. exporters also educated Chinese consumers about the health benefits of non-bleached products over bleached ones. These efforts have paid off. According to the trade, non-bleached products held only 10 percent in the market across the country in 2007, but this dramatically climbed to 30-40 percent in 2008. Local sources anticipate more than half the market will be dominated by non-bleached ones in 2009. Non-bleached pistachios are mostly sold in middle and upper markets, while bleached ones are sold in lower end markets.

Almonds. Imports of almonds from California into China significantly increased in 2008, a result of lowered prices. CIF prices for orders delivered to Hong Kong in October 2008 ranged from \$1.15 - 1.17 per pound, and fell to \$0.85 per pound in December 2008.

Though prices bounced back to \$1.00 levels in January 2009, due to peak sales season during the Chinese lunar new year, many traders did not accrue big profits from large imports in the 2008-2009 crop year, due to dropping prices.

Statistics by the Almond Board of California showed that 38 million pounds of shelled plus 18 million pounds of in-shell almonds were exported from California to China in the 2008-2009 crop year (from August 2008 to January 2009), respectively a 134 and 142 percent

leap from the same period of the previous year. Growth is expected to remain strong in 2009.

Pecan. Despite producing 80 percent of the total pecans in the world, and being the dominant supplier to China market, the United States is not the only pecan exporter to China (mostly in-shell for snacks, plus some shelled as ingredients for baked products, ice cream and candies). Mexico and Australia enjoy good product quality and hold a 15 and 8 percent share in the market by selling their products in China (mostly in-shell). China has started a very small production of pecans, but it will take another four or five years until the crops mature for commercial channels.

Up to seven U.S. varieties make it to China. The most popular is Western Schley, due to the big size and amount of meat, which sought for perfect halves. The industry sized pecan is Oversize (including Mammoth, Junior Mammoth and Junior), Extra Large, Large, Medium and Small. The price difference between half sizes and pieces is 20 cents per pound.

China is a price-sensitive market, and therefore less expensive in-shell ones are more popular. Chinese processors and traders often directly buy pecans from U.S. growers to minimize cost. Shelled pecans have limited share in the China market, and are mostly used to make prestigious food items such as Haagen Daz ice-cream and bakery items sold in Starbucks. However, the demand for shelled pecans, especially from high-end niches, is largely unleashed.

Walnuts. Despite being one of the largest walnut producers in the world, China's walnut imports (mostly from the United States) have been boosted by strong demand and surging walnut prices in the domestic market. To expand market share in China, California Walnut Commission & Walnut Marketing Board has commenced aggressive marketing efforts. High-end bakeries, snack and food manufacturers in affluent regions are targeted, given California walnuts' consistent high quality, high product standards and versatile application. To differentiate from less expensive Chinese walnuts, promotions will tout California walnuts' good taste (less bitter, sweeter than Chinese varieties) and added nutritional value, e.g., helps fight cardiovascular diseases, diabetes and weight gain.

Hazelnuts. Interest in carrying hazelnuts in general by the trade is down due to shrinking profit margins because of how the product is traded. Importers in Hong Kong used to sell

to large nut traders on the mainland who in turn sold to small mainland processors and wholesalers. The cause of the problem stemmed from traders in Hong Kong who wanted to bypass the large nut traders and sell directly to the small mainland processors and wholesalers. This caused the large mainland traders to compete with the Hong Kong traders to capture business from the small processors and wholesalers. This progressively squeezed profit margins to such low levels that most traders, especially the large ones, lost interest in buying. Given the large amount of money involved in nut imports, traders would rather carry more profitable nuts such as pistachios and almonds which are sold under the original more orderly way of trading or directly from exporters.

Critical factors for success in China's tree nut market, include constant supply, good quality control, competitive prices, product promotion and product servicing. For continuous success in China, there is a need to:

- Educate Chinese buyers on product knowledge including sizing, supply availability and proper product handling;
- Educate Chinese users on the value that U.S. tree nuts add as ingredients and the versatile application
- Provide trade service and technical assistance to users and processors through importers and distributors
- Educate Chinese consumers about health/nutritional benefits
- Retail promotion to target young consumers (aged 18-45 years, mostly female) of high-income in large cities

1.5. Macro Issues

1.5.1. Financial crisis impact

The financial crisis started from the fourth quarter of 2008 has developed into a global economic slowdown. As the second largest economy in the world and also one of the top food consumption and processing countries, China's reaction matters to the world food processing industry.

In 2008, China was not been spared from the global economic downturn – although it was less impacted than other places. Its 2008 GDP growth fell to nine percent following five years of double growth since 2003. The economy had been slowing since the beginning

of 2008 but the downturn accelerated sharply in the latter part of the year. In 2009, reliable sources believe that China will not reach its earlier eight percent growth target. Instead, most put expected growth at six to seven percent. Despite the grim news, there is some hope for a rebound: The World Bank forecasted that China's economy will improve starting in the middle of 2009.

Consumer and business confidence have weakened drastically. The global economic crisis led to the closure of 7.5 percent of China's small and mid-size companies since the end of 2008, pushing up unemployment rapidly. Officially, urban unemployment is put at only four percent but this includes only urban residents. The 20 to 40 million rural migrants, who have moved to cities to work and lost their jobs recently, are not counted.

Nevertheless, China's performance is one of the best among the major economies. Particularly, when we come to food sector, signals from different sources indicate limited impact.

ATO Beijing has been meeting with dozens of food importers and distributors and major supermarkets since January 2009 to evaluate the crisis' effects on northern China. Surprisingly, most contacts said that impact was small because food is a "daily necessity" and is very resilient to economic fluctuations. Another reason for the resilience is that China's food industry mainly relies on domestic consumption and less dependent on exports than much of the economy. In recent years, China's food exports have grown by about 20 percent while its food industry has maintained average revenue growth of over 30 percent.

The data seem to back this argument. According to the Ministry of Commerce, In Jan 2009, the top 1,000 retailers in China increased their sales value by 24.5 percent compared with the same period last year. Although two big festivals, the New Year and the Spring Festival (Chinese New Year) have contributed hugely to the increase, it still points to a resilient domestic market. Also, the freshly released data on the gross consumer goods retail value of the first quarter 2009 reported a 15 percent increase from last year.

In response to the financial crisis, the Chinese government has taken action. The biggest is the launching of the Four Trillion Stimulus Plan (equivalent to about \$588 billion), aimed at expanding domestic demand and transforming an export reliant economy to a more self supported one. This plan has selected ten industries to support, including food

processing.

The core of the stimulus plan's strategy for the food sector is to strengthen food safety.

Specifically, food processing and manufacturing industry will be further regulated. If implemented, this could compel some low cost processors and manufacturers to improve product quality or face closure. The dynamic will also likely accelerate consolidation in the industry.

Apart from the central government, local governments are also working to maintain economic growth. One shared measure among provincial and municipal governments is to issue consumption coupons, with which people could purchase daily necessities and or tourism services.

Another important food sector, food service, has faced difficulties. In many regions, it has been reported that many restaurants saw business drop sharply, even in the New Year and Chinese New Year period, the best selling time for restaurants in normal years. This decline was particularly intense for high end restaurants and hotels where business fell by 20-30 percent.

1.5.2. Melamine scandal and food safety

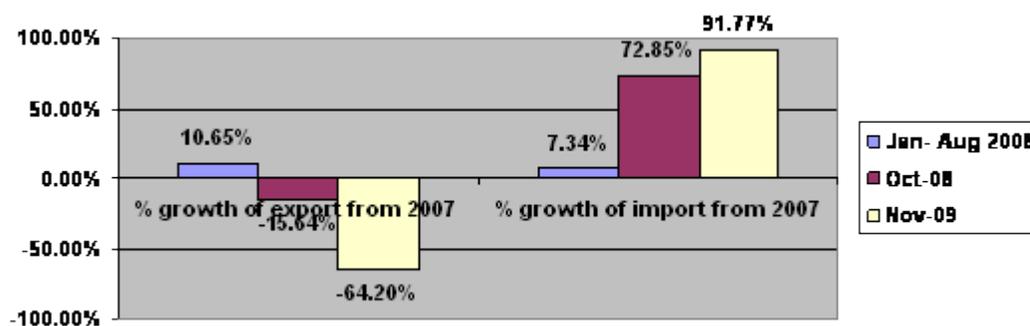
Over the past decade, China's dairy sector grew very rapidly. Unfortunately, this progress ended overnight because of contamination of melamine in infant formula milk powder. The melamine scandal was a severe blow to China's dairy industry. Melamine, a chemical which increases the value of nitrogen in a protein content test for raw milk was deliberately added into diluted raw milk to get a higher price. This milk was sold to large milk processors and on to the public. This caused 300,000 illnesses, with 12,800 hospitalizations and six infant deaths.

This scandal did not only bankrupt SanLu, but also devastated China's dairy industry. A nationwide investigation revealed that many producers, including some top dairy giants like Yili and Mengniu, had melamine in their products. Thousands of tons of dairy products of all brands without melamine testing were removed from stores. Food processors and manufacturers were required to have all dairy products and ingredients checked for melamine. Consumers across the country lost confidence in domestically produced milk and dairy products, and turned to imported milk products or such substitutes as soy milk.

Individual dairy farmers, dairy farms, and processors all badly suffered, as consumers didn't want to buy their products. Some dairy farms had to pour away fresh milk away due to decreased demand.

As a result, dairy production was fall sharply. According to the *China Dairy Industry Association (CDIA)*, China's production of dairy products fall by 0.5 percent in 2008, compared to the 12.6 percent growth in the first eight months of the year – just prior to the media exposure of the melamine cases. Fluid milk (including fresh milk, UHT milk, and reconstituted milk) production fell by 3.6 percent in 2008. This was a huge change compared to the 10.3 percent growth for the first eight months of the same year.

Figure 13: Dairy Products Import & Export Growth Rate 2008 (%)
 (Percent Growth in Exports Since 2007)



Source: World Trade Atlas

1.5.3. Food prices

Prices for agricultural commodities fallen significantly from historical highs since the global downturn. However, at the consumer end, retail prices of many processed food products remain almost as high prior to the downturn. Prices have been supported because expenditures on food, especially daily items, have fallen less than on expensive products. If adverse economic conditions continue, demand for premium food products may remain weak while demand for staple items is stable.

China's imports of food commodities partially interpret the prices fluctuation and sensitivity. For example:

Wheat. Since 2006, most wheat imports enter China via Shenzhen and Guangzhou.

Privately owned grain trading companies are active in South China and reputed for good flour quality. Flourmills usually blend imported wheat with other wheat varieties to make high quality flour. Since 2006, high wheat prices resulted from greater demand plus short supply, rising fuel and freight prices prevented Chinese millers from using imported wheat.

In 2008, China's wheat imports (mostly Durum from Canada and Australia, and, Hard Red Winter, Hard Red Spring and Dark Northern Spring from the United States) dropped 62 percent further in volume term to only 31,873 MT from CY 2007 when the import volume had fallen 86 percent from the previous year. Out of cost concerns, millers shifted from imported wheat to domestic Chinese wheat (which is slowly improving in quality).

Recently falling wheat and fuel prices have reignited the interest in U.S. wheat from Chinese buyers.

Tree Nuts. In 2008, favorable prices due to plentiful supplies and a falling U.S. dollar further beefed up China's nut imports from the US, including pistachios (mostly *Kerman*), almonds (mostly *Carmel* and *Nonpareil*), walnuts (mostly *Hartley*), hazelnuts (mostly *Barcelona* and *Ennis*) and pecans (mostly *Western Schley* and *Stuard*). According to *China Customs*, imports of U.S. pistachios in 2008 reached 18,011 tons, 106 percent surge from the previous year. Imports of in-shell almond increased 327 percent to 1,527 tons, shelled almond to 2,582 tons by 199 percent, in-shell walnuts and pecans up 149 percent to 3,517 tons and in-shell hazelnuts up 45 percent to 1,675 tons.

Dairy Products. Weakened prices in global market in late 2008, plus the melamine incident in Chinese dairy products, largely contributed to China's increase of dairy imports in 2008. To eliminate worries about domestic powdered milk of melamine contamination, food processors in China shifted to import substitutes from countries including United States, New Zealand, Australia and European countries. As a result, imports of whey rose 27 percent to 213,506 tons and non-sweet powdered milk to 7,535 tons by 83 percent.

1.6. Advantages and Challenges

Advantages	Challenges
China is the world's largest food market and also a large processor of many food categories that supply both domestic and export markets.	Slowdown in global and China's economy cools off the growth in China's food industry.

Steadily growing food industry, together with the retail and HRI sectors, create ample opportunities for food ingredients.	Consumers may spend less and expansion of the industry will likely slow.
Upscale food makers eagerly look for high quality ingredients that add value to their products.	Fragmented markets in a geographically large nation with underdeveloped logistics and infrastructure as well as cold chain system.
Increasing concerns about food safety and health creates more opportunities for high quality ingredients	Incomplete Chinese standards and discrepancy between Chinese standards and U.S. ones may create technical barriers to trade.
Food is an essential part of Chinese culture and social life.	Implementation of the new Food Safety Law may slow shipment clearance.
A large number of emerging city markets offer tremendous opportunities for further growth.	Food processing, retail and HRI sector as well as distribution channels in less developed areas lag far behind those in the affluent coastal region, hampering further penetration.
Continuously weakening dollar makes U.S. products more competitive in this price sensitive market.	Increasing commodity prices and logistics costs offset depreciation of the U.S. dollar.
China is the less affected than most by the global economic downturn.	Increased access for imports has resulted in greater competition from other exporting countries. TBT and SPS issues impact trade.
A cost advantage makes China a good base for value-added processing.	Logistics and distribution channels in newly developed area still lag.
Fast development of ports in various parts of China provides more entries for products entering China	Food companies spend less in new product development and sourcing new ingredients, given the uncertainty of the economy.
Many U.S. products and brands, such as California pistachios, <i>Budweiser</i> , <i>Coca-Cola</i> , <i>M&Ms</i> , <i>Snickers</i> , <i>Campbell's</i> , <i>Heinz</i> , <i>Wrigley's</i> , and <i>Pringles</i> have good reputation in China.	Infringement of intellectual property rights remains a serious concern in China.
Leading food makers are more likely to use imported ingredients to develop new products.	Chinese consumers are price-sensitive: imported products have difficulty competing with domestic substitutes on price alone.
Upcoming major international events including 2010 World Expo in Shanghai and 2010 Asia Games in Guangzhou provide ample opportunities to promote food products.	Basic agricultural production is not well integrated with the commercial food processing sector.

Urbanization and changes in living styles favor consumption of more processed food.	Food companies will likely spend less in new product development and sourcing new ingredients, given the uncertainty of the economy.
High-income earners favor products that can improve their quality of life, and are willing to pay a higher price.	Imports are regarded as expensive. Price-sensitive consumers are less willing to buy imported products without knowing their value.
Imported goods and raw materials from the U.S. are generally regarded as high in quality.	

1.7. Regional Development

China's food processing industry is intensively located in the most developed affluent regions along the coast, with Beijing, Shanghai and Guangdong being the centers. Southwest China, which hosts Chengdu and Chongqing, two of the top emerging city markets in China, is also developing rapidly in food industry. It is hence easier to divide China into four regions, South China, East China, North China, and Southwest China for further discussions.

1.7.1. South China

South China covers the provinces of Guangdong, Fujian, Hunan, Guangxi and Hainan, with Guangdong, one of the most developed provinces, being in the center.

South China leads the country's food processing industry due to advanced development, large sales volume, good product quality and high productivity, as well as innovation on technology and products. Being the most developed region in the country, it accommodates numerous well-established food companies and a large number of wealthy consumers. It processes a wide range of food products in large volume, from rice, wheat flour and other staple, cooking oils, beverage, poultry, seafood, dairy products, to baked goods, dried and preserved fruit, nuts and confectionaries to serve both the domestic and export market. (See *Table Below for details of food enterprises in the region.*)

Figure 14: Food Processing Industry in South China by Province 2007*

Provinces	Categories	Number of Enterprises	Annual Sales** (million US\$)
Guangdong	Food Processors	799	14,758.6
	Food Manufacturers	656	7,793.4

	Beverage Manufacturers	214	5,672.4
	Total	1,669	28,224.4
Fujian	Food Processors	746	7,330.3
	Food Manufacturers	386	3,417.5
	Beverage Manufacturers	283	2,302.6
	Total	1,415	13,050.4
Hunan	Food Processors	N/A	6,469.5
	Food Manufacturers	N/A	2,690.9
	Beverage Manufacturers	N/A	1,311.7
	Total	N/A	10,472.1
Guangxi	Food Processors	374	7,826.2
	Food Manufacturers	115	580.9
	Beverage Manufacturers	103	1,230.6
	Total	592	9,637.7
Hainan	Food Processors	71	818.0
	Food Manufacturers	25	271.4
	Beverage Manufacturers	20	309.6
	Total	116	1,399.0
Regional Total ***		3,792	62,783.6

Sources: Statistical Year Books 2008 of reported provinces

**Latest available data, including only those enterprises that realized annual sales over US\$ 657,895 (RMB 5 million) in CY2007*

*** US\$ 1 = RMB 7.6*

**** Regional total of enterprises number exclude Hunan province due to available data*

South China is a large food processing base. The Pearl River Delta area in Guangdong province, covering cities of Guangzhou, Shenzhen, Dongguan, Foshan, Zhongshan, Jiangmen and Zhuhai houses a large number of food companies. In addition, Shantou and Chaozhou in Guangdong, and Jinjiang in Fujian, as well as Lipu in Guangxi are also nationally well-known processing hubs for preserved fruit, candies, snack food, formulated milk powder, cereals and seafood processing, serving both domestic and export market.

Current global economy slowdown has placed only minimal impacts on South China's food processing industry, due to strong consumer purchase power, least affected domestic economy in China, as well as food being the necessity in life. Sales of food remain strong, despite at less steep growth rates. With conservative confidence on the economy, consumers start spending less on luxury food items in the high-end niches, and favor those of good quality but at reasonable prices. This will slightly affect the sales of pricey items, but help the sales of those in mass market of good quality but in moderate price range. Promotions of discounted prices and larger sized money worthy packages are often employed to accommodate consumers' price concerns. Companies targeting overseas

markets are the worst affected, because of shrinking demands from overseas markets and the strong Chinese currency Renminbi.

Given the uncertainty in the near term, food companies in China are shifting to less aggressive approaches. Expansion investments have shrunk, and companies started spending less in new product development. Instead, more emphasis has been put in product quality and safety which become more critically important within the current business environment. Companies also have stricter cost control to secure profitability.

South China itself is a huge market for high quality food. Two of China's four primary cities, i.e., Guangzhou and Shenzhen, as well as many wealthy emerging secondary cities including Dongguan, Foshan, Zhuhai, Zhongshan, Jiangmen and Shantou in Guangdong province, Xiamen and Fuzhou in Fujian province, as well as Nanning and Guilin in Guangxi province, have raised huge demand for high quality food products by a wealthy population. Third tier cities and rural areas in south China, especially in Guangdong and Fujian, offer substantial potential for future development, given the relatively higher level of development and income, compared to those in inland region.

Good quality food products are popular in South China for daily consumption and gifting, and food forms an important part in the regional subculture. A lot of common food, even fruit and vegetables, meat, beans and nuts are well perceived by southern consumers of certain particular health benefits, which has been widely used by food manufacturers in new product development and promotion.

1.7.2. East China

With a population totaling 120 million and advantageous geographical position, the Yangtze River Delta, which boasts one of the most vibrant regional economies in China, is home to Shanghai, Zhejiang Province, and Jiangsu Province, all ranked among the top ten players in terms of economic strength. With its area only 2.1 percent of the total, and population only 11 percent of the total in China, their combined gross domestic product (GDP) reached \$823 billion in 2008, exceeded 22 percent of the nation's total, and its financial revenue amounted to 31.5 percent of the nation's total. The 16 cities in the three places absorbed over 35 percent of the actual foreign direct investment (FDI) in China over the past ten years.

The food processing industry is a fast growing sector in the economy of Yangtze River Delta Economic Zone (YRDEZ). The region's affluence, high density population, sound

industry infrastructure, and easy access to seaports all attributed to the prosperity of their food processing industry. The numerous food processors in Shanghai, Nanjing (Jiangsu Province), Kunshan (Jiangsu Province), Suzhou (Jiangsu Province) and Hangzhou (Zhejiang Province) build strong reputation of the food processing industry for east China, and fostered many famous brands of packaged food products and beverage products.

The strength of the food processing industry in YRDEZ lays in dairy products, meat products, seafood products, snack foods, instant noodles and drinks & beverages. The Bright Food Group which is headquartered in Shanghai owns many nation-wide famous brands, including Bright Dairy for dairy products, Big White Rabbit for candy, Zheng Guang He for drinks and beverages, Ai Sen for processed meat products, Meilin for canned food products, Guan Sheng Yuan for honey products and Shi Ku Men for rice wines. Zhong Cui Foods headquartered in Hangzhou, the strategic global partner of Coca-Cola, is a leading producer of Coca-Cola with annual sales hitting \$220 million. The biggest domestic beverage brand Wahaha is also created in Hangzhou, Zhejiang Province.

Ningbo, benefiting from its coastal location in Zhejiang Province, produces various kinds of processed seafood which are widely distributed throughout China. Jiangsu Province is very strong in meat products and snack foods processing. Yu Run, one of China's most famous processed meat product brands, is located in Nanjing. Kunshan and Suzhou attracted huge investment of foreign food manufacturers including Nabisco and Rich Products from U.S., Pokka Four Seas from Japan, Loyal Food Industrial from Canada, President Instant Noodles from Taiwan, and Po Li Foods from Panama.

In 2008, the output value of the preliminary processors of agricultural products dropped by 5 percent, while the gross output value of manufacturers on more in-depth processed food increased by 26 percent over the previous year. Numbers of food & beverages manufacturers are rather stable through 2007 to 2008. The status reflected that the food processing industry in the YRDEZ has been addressing the rising labor and environmental costs, together with the appreciation of Chinese RMB, which are causing a major industrial shift. While new enterprises are still being created to tap this vigorous market, some smaller manufacturers are moving out of the region to make ends meet.

Figure 15: Food Processing Industry in East China by Province 2007

Provinces	Categories	Number of Enterprises	Gross output value (1 million RMB)
Shanghai	Food Processors	170	20,844
	Food Manufacturers	259	28,856
	Beverage Manufacturers	60	13,442
Jiangsu	Food Processors	1,221	46,264

	Food Manufacturers	328	23,776
	Beverage Manufacturers	220	21,646
Zhejiang	Food Processors	N/A	52,272
	Food Manufacturers	N/A	20,596
	Beverage Manufacturers	N/A	24,520
Total		N/A	252,216

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

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

Shanghai residents spent 35.7 percent of their disposable income on food in 2008. A growing percentage of that amount was spent on imported products as well as products with imported ingredients, such as dairy products, snack foods, tree nut products and confectionary items. Consumers are willing to pay premium prices for branded products i.e. Alaska seafood with more variety and higher quality, and they are more receptive to new flavors from overseas countries. Additionally, Shanghai residents spend a sizable portion of their income dining out, increasingly at western or chain restaurants that use imported products such as U.S. poultry, pork, seafood and potato products. Chain pizza restaurants such as Pizza Hut and Papa John's that use American potato products and cheeses, for example, are increasingly popular among the younger generation.

YRDEZ remains a very promising potential market for U.S. bakery ingredient exporters. The improving incomes and consumption ability are driving consumers in east China to become more lifestyle-focused, and the quickening pace of life is making ready-to-eat and prepared foods more accepted. Bakery foods, including breads, rolls, cakes and morning pastries are also becoming more popular.

While traditional Chinese pastries such as moon cakes still remain dominant, consumers are becoming more sophisticated and becoming increasingly demanding for greater variety in and quality of bakery products in Shanghai. Premium chain bakeries continue playing a leading role in distribution, and competition among them is fierce. While older chain stores such as Marco Polo enjoy consumer loyalty thanks to their consistently high product quality, newcomers like Bread Talk and Yamazaki are trying to gain market share by introducing innovative flavors, interesting product names, on-site baking, and eye-catching store images.

Imported U.S. bakery ingredients such as dried fruits, almonds, hazelnuts and raisins are frequently used in manufacturing bakery products at high-end bakeries, aiming to enhance

nutrition and improve appearance with the consequence of bringing the products higher margins.

Post believes that a healthy lifestyle concept is building among the affluent urban residents in the YRDEZ, and because of that, a new demand for convenient, healthy, low-fat and fortified food products is expected to grow. Major events including the approaching 2010 World Expo to be held in Shanghai will create additional growth opportunities for HRI and retail players.

1.7.3. North China

North China is home to 15 provinces, special municipalities and autonomous regions, from highly developed Beijing to poor Gansu and Qinghai. The region covers about half of the land size of China, spreading from the east tip facing the Pacific Ocean in Shandong to inland Xinjiang. The provinces within the region vary so much geographically, socially, economically and culturally, and it is too hard to talk about them as a whole. While the region is vast, the majority of its food processing operations is largely clustered in the eastern part of the region, mostly in Beijing, Tianjin, Henan, Shandong and Inner Mongolia.

The strength of the food processing industry in North China is in meat processing, seafood processing, beer brewery, dairy products, and instant noodles. It is estimated that 1 out of every 3.5 packages of instant noodles, and 5 out of 10 of packages of ham sausages produced in China are made in Henan Province alone. The largest meat and poultry processor, Henan Shineway Group (Shuanghui), and Sanquan the leading producer of frozen dumplings are both located in Henan Province.

Seafood processing is one of North China's major food processing industries and is mostly concentrated along the coastal cities of the Bohai and Yellow Seas, especially in Shandong and Liaoning provinces. In 2007, China imported \$2.4 billion in fishery products from the United States with around 85 percent of these products used for processing and re-export.

Beer production is among the most significant processing industries in the region. Big brands including Snow, Yanjing and Tsingdao are all located in the region. Yanjing Beer occupies a dominant 50 percent market share in North China, more than 90 percent of the Beijing market. To supply the market, it operates the single largest beer manufacturing

facility in Asia.

At the same time, Inner Mongolia is home to some dairy giants. The top two dairy producers in China, Mengniu and Yili are both based there. Another big player, Sanyuan, is in Beijing.

Apart from Beijing, North China hosts a big group of emerging city markets, including Tianjin, Qingdao, Dalian, Zhengzhou, Xi'an, Shengyang, Dalian, and Harbin. These cities have demonstrated strong development trend over the past years, averagely boasting a yearly GDP growth of around 15 percent. Companies in purpose to expand their market share should never ignore these cities.

Figure 16: Major Provinces' Food Processing Industry in Northern China by Province 2007*

Provinces	Categories	Number of Enterprises	Annual Sales (1 million RMB)
Beijing	Food Processors	214	1,890
	Food Manufacturers	184	3,731
	Beverage Manufacturers	63	3,625
Tianjin	Food Processors	163	20,853
	Food Manufacturers	138	9,884
	Beverage Manufacturers	50	8,707
Henan	Food Processors	1488	158,124
	Food Manufacturers	419	53,568
	Beverage Manufacturers	313	33,195
Shandong	Food Processors	3768	45,696
	Food Manufacturers	1106	115,750
	Beverage Manufacturers	463	62,713
Liaoning**	Food Processors	1067	74,859
	Food Manufacturers	307	13,292
	Beverage Manufacturers	173	9,523
Inner Mongolia**	Food Processors	392	26,731
	Food Manufacturers	106	29,626
	Beverage Manufacturers	86	5,568

Sources: Statistical Yearbook 2008 of the reported provinces

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

** Liaoning and Inner Mongolia statistics are from the Yearbooks 2007.

1.7.4. Southwest China

Rapid growth, consumerism and love of food are defining characteristics in Southwest China and boosting the development of food processing industry in this region. Southwest China, which includes Chengdu and Chongqing, two of the top emerging city markets in China, has a population of 200 million and a regional GDP of \$330 billion. Reflecting

China's commitment to market development in China's interiors, growth for the regions' largest cities has been among the highest in the nation. Sichuan province is a powerhouse in the region, and shares borders with Chongqing in the east, Yunnan and Guizhou in the south and Tibet Autonomous region in the west. With 19 million hectares cultivated land, about 15.7 percent of total national arable land, Southwest China region produces \$91 billion value of agricultural products annually, accounting for 27.6 percent of region's total GDP. This gives abundant resources for the food processing industry in Southwest China. There are more than 2,570 food processing companies in the Southwest China region, and most of them are located in Chengdu, Chongqing, Kunming, Guiyang and their surrounding areas. About 57 percent are food processors, 19 percent are food manufacturers and 24 percent are beverage manufacturers.

Figure 17: Food Processing Industry in Southwest China by City and Province 2007*

Provinces & Cities	Categories	Number of Enterprises	Gross Output (Million US \$)
Sichuan	Food Processors	886	12,937.1
	Food Manufacturers	331	2,665.9
	Beverage Manufacturers	368	9,165.3
Chongqing	Food Processors	223	2,029.4
	Food Manufacturers	71	563.3
	Beverage Manufacturers	51	741.6
Yunnan	Food Processors	231	2,956.2
	Food Manufacturers	53	368.8
	Beverage Manufacturers	112	984.6
Guizhou	Food Processors	127	678.0
	Food Manufacturers	40	396.3
	Beverage Manufacturers	77	1,524.1
Regional Total		2,570	35,010.6

Data sources: Sichuan, Chongqing, Yunnan, Guizhou Statistical Year Books 2008

* Latest available data, including only those enterprises that realized annual sales over US \$ 735,294 (RMB 5 million) in FY 2007

* US \$ 1 = RMB 6.8

Local manufacturers dominate food processing industry. In Southwest China food processing market, many small and local brands are more popular than national brands. Because multinational and national brands mainly focus on North and Northeast China, East China or South China due to these regions' rapid economy. This leaves space for small and local brands to grow sales and gain market share. For example, local chips brand Zidi from Kunming Zidi Foods Co Ltd is extremely popular in Southwest China, because its price is more affordable than those of leading brands such as PepsiCo's Lay's. In addition, its distribution network also extends wider and deeper than those of national

and multinational brands. Chengdu Xiwang Food Co. Ltd and Chengdu Woteam (Wu Tian) Food Ltd similarly have strong shares in chilled processed food in the region, even exceeding national leaders such as Shineway Group and China Yurun Food Industry Group Co Ltd.

Figure 18: Market Sizes by Food Categories in Southwest China*(Million US \$)

Southwest China	2003	2004	2005	2006	2007	2008
Packaged food	6,784.5	7,770.4	8,651.35	9,633.2	10,791.3	11933.9
Frozen processed food	327.4	355.3	377.40	402.2	443.1	490.2
Dried processed food	761.0	829.6	901.06	986.7	1,115.7	1208.9
Chilled processed food	649.3	689.9	733.50	784.5	887.1	985.3
Canned/preserved food	396.9	412.2	427.43	442.8	464.8	496.1
Bakery products	968.3	1,047.3	1,120.57	1,209.7	1,293.4	1377.7
Baby food	163.7	186.9	222.97	278.1	345.1	420.1
Noodles	649.8	702.2	757.22	823.8	930.5	999.6
Sauces, dressings and condiments	673.4	694.9	719.04	745.5	813.7	874.4
Sweet and savory snacks	388.6	414.8	442.56	472.7	504.2	537.9
Confectionery	704.9	763.4	821.97	880.2	941.9	997.3
Ice cream	442.3	503.9	557.12	615.9	681.4	755.0

Sources: *Euromonitor from trade sources/national statistics*

**Retail value RSP, valued at current prices, US \$1 = RMB 6.8*

National and multinational brands manufacturers to gain share in Southwest China.

Leading national and multinational manufacturers also began to enter and are expected to gain a higher share in Southwest China Market. With less competition, leading manufacturers will find it easier to gain share in the region. President Enterprises (China) Investments built their \$20 million processing factory in Chengdu, Sichuan in 1993, and now Chengdu Uni-President Enterprises Food Co. Ltd. is the largest food processing company in Sichuan in terms of sales volume. Their annual sales revenue reached \$161 million in 2006. Ting Hsin International Group also performs strongly in Southwest China due to strong marketing strategies, and they have been present in bakery products, dairy products, noodles and baby food. Coca-Cola set up Chengdu Coca-Cola Beverage Co., Ltd. in 1996, and has ever since played a big role in the local beverage market. Leading sauces manufacturer Lee Kum Kee is planning to strengthen its presence in Southwest China, as it is already performing well in East and South China regions. Foreign investment in food processing industry is likely to increase in Southwest China. Low production costs in the region will be attractive to multinational manufacturers, including low rental costs, labor costs and raw material costs.

Flavor preferences in Southwest China – high usage of flavor-adding products.

Consumers in Southwest China prefer strong flavors and hot and spicy foods. Therefore, local flavors are important for food processors. Due to these taste preferences, there is a high usage of condiments, spices, sauces and pickle products, thus a lot of local famous food processors are producing condiments, sauces or pickle products. Local manufacturers, such as Sichuan Haoji Food Co. Ltd, Chengdu Jingong Weiye Food Co. Ltd, Sichuan Pixian Bean Paste Co., Ltd., Guiyang Nanming Laoganma Flavoring Food Co. Ltd., Chongqing Zijialu Spice Co., Chongqing Fuling Pickled Product Group, and Chengdu Xinfan Kraut Co. Ltd, are the most popular brands and main suppliers to foodservice operators.

Chocolate confectionery products. In chocolate confectionery products, Effem Foods (Beijing) Co Ltd's Dove, Cadbury (China) Food Co's Cadbury, COFCO Le Conté Food (Shenzhen) Co Ltd's Le Conté and Shanghai Hershey Food Co Ltd's Hershey's dominate over 70% of value shares overall. Small local brands were squeezed out in this area.

Small brands could not compete with multinational brands in terms of taste, brand awareness, distribution, marketing or sales promotion and thus lost share.

Bakery products. In bakery products, private label saw a strong increase in value share in 2007. Leading multinational retailers such as Wal-Mart and Carrefour all offer their own private label bakery products. Due to the high quality image of multinational retailers, consumers in Southwest China have a strong confidence in their private label products. Wal-Mart's private label Great Value saw strong sales due to its low price and high quality. Moreover, in-store bakeries proved popular in hypermarkets, as consumers viewing these as offering fresher bakery products.

Dairy products. In following the melamine contamination milk scandal in 2008, consumers' confidence was hit, especially for those contamination related brands. Fortunately, none of the 44 Sichuan dairy manufactures' products were reported to be melamine contaminated. As consumers lost confidence for leading dairy manufacturers like Inner Mongolia Yili Industrial Group Co Ltd, Inner Mongolia Mengniu Milk Industry (Group) Co Ltd, and Bright Dairy & Food Co Ltd, consumers are turning back to local dairy brands. Since the tainted milk scandal, the sales of both Mengniu and Yili dairy products have dropped dramatically, leaving more opportunities for local dairy producers not involved in the scandal. Sichuan dairy manufacturers even plan to expand into the national market in 2009. Sichuan major dairy manufacturers, including New Hope Group

and Chengdu Jule Group have developed national marketing strategies for 2009. Sichuan New Hope Group aims to increase dairy products sales by 50 percent to \$300 million in 2009 and to be one of the top five dairy producers in China.

Opportunities for U.S. food manufacturers and ingredients suppliers. Having good image of quality, health, and safety, U.S. food products and ingredients would find large potential market in this area. With sustained and rapid growth of per capita disposable income, consumers in Southwest China become increasingly focusing on products' quality, flavor and nutrition in addition to price. This would boost sales of U.S. high-quality rice, soybean, corn, dried fruits and nuts, and premium canned and packaged food. Love of strong flavors in this region also provides a tremendous sales opportunity for U.S. high-grade sauces, dressings and condiments manufacturers. When targeting this area's customers, U.S. food manufacturers may consider adding local preferred flavors, and some popular herb extracts ingredients such as honeysuckle and chrysanthemum, which are treated as healthy ingredients in local market. As healthy-eating trend becomes more popular, the consumption of better quality U.S. food products would increase by a large portion. The melamine contamination milk scandal also offers a good opportunity for U.S. dairy companies to expand in China, as consumers are demanding high quality dairy products and becoming more aware of food safety problems.

SECTION II. ROAD MAP FOR MARKET ENTRY

2.1. Entry Strategy

Being one of the world's largest and most rapidly growing food markets and processing countries, China is very attractive for any food ingredients producers or exporters aiming to expand their business. The continued growth in the local economy despite the world economic crisis increases the attractiveness of the market even more. Despite the unique opportunities of the China market, there are some issues to market entry.

One, **China is not a unified market.** On the contrary, it is extremely diverse and fragmented, in terms of products types and regional differences. China's food market is diverse and fragmented, making it possible to fail at the starting line if this homework is not well done. Therefore, it is hard to summarize an entry strategy which is applicable to all regions.

Two, **thorough market research** is needed before trading in China. Exporters need to consider how factors such region, age group, and eating preferences relate to the product being exported. This report provides some initial impressions but more analysis is definitely needed on specific products.

Three, it is critical to find **good importers and distributors**. Try to find those who have not only established wholesale and retail outlets but also relationships in the target market. They should not only be able to make orders for a product but also make sure the product is penetrating the market and can grow in the future. The best distributors might have technicians on staff and experience working with other exporters. Where possible, it is recommended to visit their facilities and warehouses especially if a product is highly perishable.

Four, **exhibitions** can be a cost effective approach to understanding the market and meeting agents/importers. Some valuable exhibitions in China include FHC (Food & Hotel China), China Fisheries & Seafood Expo, SIAL China, China International Meat Industry Expo, and FIC (Food Ingredients China) and so on. One could contact ATO offices for more information on these exhibitions.

Five, be open to **different importing channels**. Although lean economic times have driven some processors, manufactures and hypermarkets to consider the direct sourcing of products from producers to reduce costs, this is not always possible. According to the Beijing Youth Daily, some major hypermarkets and supermarkets are now sourcing 30 percent of fresh fruit and vegetable products directly from farmers. By doing so, hypermarkets would be able to not only enhance traceability for the products purchased, but also reduce costs by 20-30 percent. Some big hypermarkets such as Carrefour in Beijing expressed their wish to directly source from outside of China, particularly on products like fruits. Despite this, in some cases it might not be possible to get into China market while bypassing importers/distributors. Therefore, where possible, producers/exporters are recommended to approach the leading firms of their sectors to look into the possibility.

Six, **Chinese business culture matters**. The most distinctive highlight of the Chinese business cultures is the need to cultivate Guanxi, or relationships. Conventionally, Chinese value friendships very much, which implies that if one has a shared friend or some other form of connection with the potential Chinese partner, he may get a more favorable price,

or be favored among other competitors. Although the influence of Guanxi is slowly falling as China modernizes, it is still very important.

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

2.2. Market Structure

2.2.1. Distribution pattern

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

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

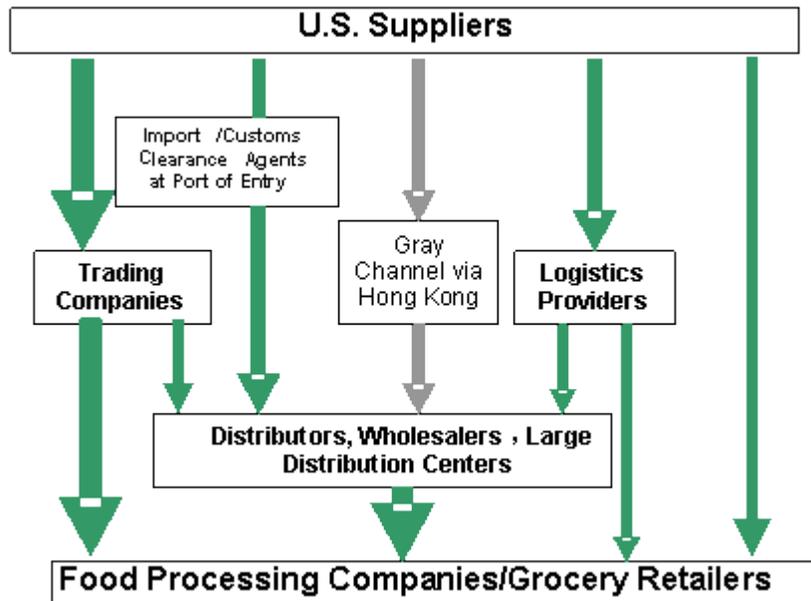
Direct Selling to Large Sellers/Processors/manufactures. Some large sellers/processors/manufacturers are considering the direct sourcing products from exporting countries to reduce costs. If connections to the supplier can be built, this could be an opportunity for producers/exporters.

Whatever options to take, the importing process may involve services from logistics

providers and/or customs clearance agent.

To summarize the above discussions into a flow chart as below.

Figure 19: Distribution Flow Chart



Source: ATO

Note: ATO Beijing does not recommend the use of the gray channel.

2.2.2. Distribution channel

The reason to raise this issue is, apart from the legal channel, there is a Gray Channel when exporting to China. It refers to shipments via Hong Kong through local import agents that have distribution connections on the mainland. This channel has historically been cheaper than mainland channels. There can be cost savings since goods are often shipped from Hong Kong outside of official channels or using various methods to evade customs and VAT payments. However, the U.S. supplier has little control over their product after it reaches Hong Kong and technical support and supplies are not reliable. Since this channel is illegal, USDA does not encourage its use.

2.2.3. Distribution flow

China is generally divided into three regions.

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

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

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

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

Figure 20: Volume of Freight Handled in major Coastal Ports 2003-2007 (10, 000 tons)

Seaport	2003	2004	2005	2006	2007
Shanghai	31,621	37,896	44,317	47,040	49,227
Ningbo-Zhoushan	18,543	22,586	26,881	*42,387	47,336
Guangzhou	17,187	21,520	25,036	30,282	34,325
Tianjin	16,182	20,619	24,069	25,760	30,946
Qingdao	14,090	16,256	18,678	22,415	26,502
Dalian	12,602	14,516	17,805	20,489	24,893
Qinhuangdao	12,562	15,037	16,900	20,046	22,286
Total	122,787	148,430	173,686	208,419	235,515

Source: China Statistical Yearbook, 2008

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

2.2.4. Cold Chain

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

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

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

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

In addition, there are no consistent standards for food quality and safety. There is inadequate inspection and ineffective enforcement. Fragmented, unclear rules and regulations exacerbate cold chain problems. There are no national laws or regulations governing food safety in storage, transportation, distribution and retail.

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

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

Having realized the urgent needs of a developed cold chain transportation system, the

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

There will also be money for the sector. In response to the global economic recession, the Chinese government has raised the RMB Four Trillion Stimulus Plan, where logistics industry has been selected to join other nine other light industries to share funding.

2.3. Company Profiles

Figure 21: Top Companies in Different Food Sectors 2007 (RMB million)

Company	Total Revenue	Major Products	Production Location (City, Province)
Meat Products and Sideline Products Processing			
Xingcheng Jinluo Meat Products Co., Ltd	2000+	Chicken Products	Linyi, Shandong
Luohe Shineway Group Co., Ltd	2000+	Meat Products	Luohe, Henan
Delisi Group Co., Ltd	2000+	Meat Products	Weifang, Shandong
Yurun Food Co., Ltd	2000+	Cooked Meat Food	Nanjiang, Jiangsu
Frozen Aquatic Products Processing			
Homey Group Co., Ltd	2000+	Marine Products	Weihai, Shandong
Xixiakou Group Co., Ltd	2000+	Aquatic Products	Weihai, Shandong
Fish Surimi and Dry & Preserved Aquatic Products			
Longshan Eel Industry Joint Company	1500-2000	Roast Eel	Zhenjiang, Jiangsu
Xulong Food Group	1000-1500	Roase Eel	Ningbo, Zhejiang
Tengxin Food Stock Co., Ltd	1000-1500	Fish Ball	Fuzhou, Fujian
Changhua Aquatic Foodstuffs Co., Ltd	1000-1500	Imitated Crab Meat	Rizhao, Shandong
Baiyang Sea Foods Co., Ltd	500-1000	Aquatic Products	Fuzhou, Fujian
Ayeshan Group	300-500	Imitated Crab Meat	Rizhao, Shandong
Vegetable, Fruit and nut Processing			
Strong Fruit Jelly manufacturing co., Ltd	2000+	Fruit jelly	Yangjiang, Guangdong
Dongsheng Group	1500-2000	Peanut Products	Qingdao, Shandong
Wanfu Group	1000-1500	Quick-Frozen Vegetables	Qingdao, Shandong
Huatai Food Co., Ltd	500-1000	Melon Seeds	Hefei, Anhui
Pastry and Bread			
Christing Food Co., Ltd.	1500-2000	Cake	Shanghai
Orion Food Co., Ltd	1500-2000	Chocolate Pie	Langfang, Hebei

Biscuit and Other Baked Foods			
Pepsico Snack (China) Co., Ltd.	2000+	Food	Shanghai
Dali Food Co., Ltd	2000+	Food	Jinan, Shandong
Candy and Cholate			
Xsu-Chi Food	2000+	Candy	Dongguan, Guangdong
Wrigley Chewing Gum	2000+	Chewing Gum	Guangzhou, Guangdong
Quick Frozen Foods			
Longda Food	2000+	Food	Yantai, Shandong
Tianjing Food	2000+	Food	Changchun, Jilin
Liquid Milk and Dairy Products			
Mengniu Dairy Group	2000+	Dairy products	Huhhot, Inner Monglia
Yili Indsutrial Group	2000+	Dairy Products	Huhhot, Inner Monglia
Bright Dairy & Food	2000+	Dairy Products	Shanghai
Canned Meat and Poultry			
Fuxi Foods	2000+	Frozen meat	Shanghai
Fengcheng Huaying Fowl Industry	1000-1500	Poultry	Yichun, Jiangxi
Canned Seafood			
Haishen Foods	1000-1500	Canned Food	Ningbo, Zhejiang
Dongfang Canned Food	300-500	Canned Food	Foshan, Guangdong
Canned Vegetable and Fruits			
Maling Aquarius	2000+	Canned Food	Shanghai
Yeshu Group Haikou Canned Food	1000-1500	Beverage	Haikou, Hainan
Soy, Edible Vinegar and Similar Products			
Haitian Flarouring Food	2000+	Soy Sauce	Foshan, Guangdong
Hengshun Group	2000+	Vinegar	Zhenjiang, Jiangsu
Nutritious and Health Care Food			
Wang'S Bee Garden	1500-2000	Bee Products	Nanchang, Jiangxi
Perfect (China)	1000-1500	Health Foods	Zhongshan, Guangdong
Frozen Beverages and Edible Ice			
Walls (China)	1000-1500	Ice Cream	Beijing
Walls (China) Taicang	500-1000	Frozen Beverage	Suzhou, Jiangsu
Liquor			
Wuliangye Group	2000+	Distilled Spirit	Yibin, sichuan
Xinghuaacun Fen Chiew Group	2000+	Distilled Spirit	Lvliang, Shanxi
Chian Kwechow Moutai Distillery	2000+	Distilled Spirit	Zunyi, Guizhou
Beer			
Yanjing Beer Group	2000+	Beer	Beijing
Zhujiang Beer	2000+	Beer	Guangzhou, Guagndong
Tsingtao Brewery	2000+	Beer	Qingdao, Shandong
Fruit & Vegetable Juice and Beverage			
North Andre Juice co., Ltd	2000+	Syrup	Yantai, Shandong
Haisheng Fruit Indsutry Development	2000+	Syrup	Xi'an, Shanxi

Source: China Markets Yearbook 2008

2.4. Sector Trends

Figure 22: Foreign Funded Food Industry, 2007

	Number of firms		Sales Revenue	
	Number	% share of industry total	RMB 100 million	% share of industry total
Food Processing	2,474	13.6	4,889.55	28.5
Manufacture of Foods	1,475	22.2	2,304.54	39.4
Manufacture of Beverages	717	16.2	1,917.28	38.4
Total	4,666	16%	9,111.37	32.6%

Source: China Statistical Yearbook 2008

Seeing potential in the market, many big international food players have built establishments in China, including Coca Cola, Pepsi, Danone, Cadbury, Cargill, Hormell, Purdue, Nestle, Kraft, Pilsbury, Yum!, Chaeron, Campbell's, Kellogs, Smithfield, McCormick, and Heinz. As a result of this investment, foreign firms 16 percent of the total large food industry enterprises, with 32.6 percent of total sales revenue.

In 2009, FDI is expected to slow. A survey of U.S. companies in the country published in March 2009 by the American Chamber of Commerce in China found that 39 percent of respondents are postponing or have cancelled planned investments this year, while 21 percent expect to shrink their China work forces. According to the Ministry of Commerce, the first quarter of 2009 witnessed a decline of newly approved FDI companies to 4,554, down by 34.5 percent. Also, the actually used FDI dropped to only \$21.78 billion, down 20.6 percent. However, it should be noted that the dropping rate on actually used FDI has been narrowing over the past three months, from 32.7 to 15.8 percent and then 9.5 percent. Investment is coming in but much more slowly.

In response to this, the central government has allowed local governments to approve certain foreign investments, shifting control away from Beijing in a move to facilitate foreign investment. Under the new rules, foreign businesses setting up an investment company with registered capital of less than \$100 million will need to seek approval only from local commerce bureaus.

SECTION III. COMPETITION

Figure 23: Ingredients Competition 2008

Product Category	Major Supply Sources in 2008	Strengths of Key Supply Countries	Advantages and Disadvantages of Local Suppliers
Poultry (0207) Import value: \$1,087.151 mil	<ul style="list-style-type: none"> U.S. \$810.286 mil - 74.53% Argentina \$240.086 mil - 22.08% 	<ul style="list-style-type: none"> Argentina products more price competitive averaging at \$1.25/Kg than U.S. products at \$1.32/Kg in 2008 US products contain more moisture. 	<ul style="list-style-type: none"> Insufficient domestic production ability.

- The U.S. and Argentina jointly account for over 96% of total imports. The United States dominates the sector by exporting nearly three quarters of the total. Over the past three years, the U.S. has been successfully maintained a share of over two thirds.
- Brazil, another major exporter of poultry products to China, was suspended out of China's concern that its exports were originating from plants not registered by AQSIQ. Currently, only one Brazilian plant is eligible to export to China. As a result of Brazil's suspension, the United States has capitalized on a portion of Brazil's lost market share.
- Over the past three years, China's imports have doubled from less than \$500 million to over \$1 billion.

Pork (0203) Import value: \$523.385 mil Import volume: 372,940,374Kg	<ul style="list-style-type: none"> U.S. \$312.295 mil - 59.67% France \$71.394 mil - 13.64% Denmark \$70,410 mil - 13.45% Canada \$62.279 mil - 12.09% 	<ul style="list-style-type: none"> All other major competitors enjoy a price advantage. France and Denmark below \$1/Kg, and Canada \$1.5/Kg while US at \$1.77/Kg. 	<ul style="list-style-type: none"> Undeveloped disease control system threatens domestic production. Disease control system has been tightened by the government, which will help stabilize domestic production. The newly introduced swine price alert system will contribute to stabilizing domestic production as well.
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- U.S. dominates the market by taking a share of nearly 60% of China's total imports.

Beef (0202) Import value: \$9.991 mil	<ul style="list-style-type: none"> Australia \$6.458 mil - 64.65% 	<ul style="list-style-type: none"> Not banned by the Chinese government for 	<ul style="list-style-type: none"> Lower prices as advantage but meanwhile lower
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	<ul style="list-style-type: none"> Uruguay \$3.188 mil - 31.91% New Zealand \$0.278 mil - 2.79% 	BSE.	quality as well.
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- Australia is the predominant supplier of China's direct beef imports (over 60% of total imports) and this is expected to continue barring a change in China's trade policies.
- It is forecasted China's direct beef imports in 2009 will decline due to reduced beef demand in high-end hotels and other restaurants, as a result of the reduction of foreign tourists caused by the financial crisis.

Fish and seafood (03) Import value: \$3,657.257 mil	<ul style="list-style-type: none"> Russia \$1,221.645 mil - 33.40% U.S \$518.618 mil - 14.18% Norway \$183.353 mil - 5.01% 	<ul style="list-style-type: none"> Norway has successfully built a high quality image for its seafood in the minds of the Chinese consumers, thanks to its continuous and large scale market promotion in China. 	<ul style="list-style-type: none"> Deterioration of fishery resources and overfishing continue threatening domestic fishery ecological environment. Food safety-related incidents increase along with production growth. Fishery production is increasingly affected by natural disasters including storms, typhoons, and unexpected freezing temperatures.
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- Russia and U.S. lead in exporting seafood to China.
- While U.S. is taking only less than half of the Russia's share, it is worth noting the United States has made small but steady gains in the market over the past three years.
- About 40% of China's seafood imports are processing trade driven and re-exported to other countries. U.S. is the second largest seafood exporter to China and at the same time the largest seafood importer from China.
- Norway is taking the lead in exporting fresh salmon to China for domestic consumption. Salmon is becoming popular among mid-class Chinese.

Dairy (04) Import value: \$873.983 mil	<ul style="list-style-type: none"> New Zealand \$321.189 mil - 36.75% U.S. \$151.189, - 17.38% Australia \$126.260, - 14.45% France \$118.473, - 13.56% 	<ul style="list-style-type: none"> The rooted image of their high qualities in the minds of the Chinese consumers. 	<ul style="list-style-type: none"> Competitive prices but lower quality. Unregulated development and insufficient quality supervision. Lost trust from the consumers. The newly released Food Safety Law will help rebuild the
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			reputation of domestic products.
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- For years, New Zealand, the U.S., Australia and France have been taking the lead on exporting dairy products to China, and the U.S. has been following New Zealand to be the second.
- Impacted by the melamine scandal, China's dairy trade experienced extremes in 2008. The robust export growth in the first nine months was turned to drastic import since the scandal exposed.
- While New Zealand is still the leader measured by value, the U.S. is actually the winner in terms of volume.
- It would take some time for China's dairy producers to recover and it is still good time for the U.S. to expand its market share in China.

Vegetable (07) Import value: \$583.020 mil Import volume: 2,358,840,413Kg	<ul style="list-style-type: none"> • Thailand \$253.304 mil - 43.45% • Vietnam \$116.361 mil - 19.96% • Canada \$70.465 mil - 12.09% • Myanmar \$52.031 mil - 8.92% • India \$34.935 mil - 5.99% • Indonesia \$21.715 mil - 3.73% • U.S. \$19.538 mil - 3.35% 	<ul style="list-style-type: none"> • The major Asian exporters enjoy a price advantage averaging \$0.19-0.43/Kg, and the U.S. at about \$0.88/Kg • The other major exporters in Asia take advantage of their shorter transportation distances and costs. 	
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- This market has traditionally dominated by Asian countries, like Thailand, Myanmar, India and Indonesia. The U.S. takes a mere share of 3.35%.
- The U.S. is dominates the third largest sub-component Frozen Vegetables (0710); however, this sub-component is only less than 3% of the total market measured by value.

Edible Fruits and Nuts (08) Import value: \$1,237.204 mil	<ul style="list-style-type: none"> • Thailand \$305.437 mil - 24.69% • Vietnam \$218.729 mil - 17.69% • U.S. \$189.384 mil - 15.31% • Philippines \$136.616 mil - 11.04% 	<ul style="list-style-type: none"> • The U.S. is high in price at \$1.46/Kg, compared with the Asian competitors ranging from \$0.46-0.83/Kg. • Asian rivals enjoys their cheap transportation costs to China 	<ul style="list-style-type: none"> • Local products well suit the tastes of the Chinese. • Local producers are less proactive at product innovation • Local products lack varieties.
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- The U.S. is the only non-Asian countries listed on the top exporters of edible fruits and nuts to China.
- This category is highly fragmented, as China imports a wide range of fruits and nuts from

various countries, including: (0802) other nuts like almonds, hazelnuts, pistachios etc.; (0803) bananas and plantains; (0806) grapes and raisin; (0811) frozen fruit and nuts, including strawberry, raspberry, and blackberry, etc.; (0804) date, fig, pineapple, etc.; (0813) other dried fruit, including dried longan and plums; (08050) citrus, fresh or dried; and (0801) coco, Brazil nuts, cashew nuts.

- The U.S., Russia, Iran and South Korea are the main nut exporters to China.
- Thailand, the U.S., Philippines, Vietnam, Chile, New Zealand, Australia and South Africa are the main exporters of fruit.

<p>Baking related (19) Import value: \$716.920 mil</p>	<ul style="list-style-type: none"> • Singapore, \$177.185 – 24.72% • New Zealand \$124.018 - 17.30% • Australia, \$93.677 – 13.07% • Denmark, \$56.726 – 7.91% • Netherlands, \$41.766 - 5.83% • Hong Kong, \$30.947 – 4.32% • Malaysia, \$29.244 – 4.08% • Ireland, \$27.580 – 3.85% • U. S. \$23.430 – 3.27% 		<ul style="list-style-type: none"> • Local products well suit the tastes of the Chinese. • Local products lack varieties
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- The U.S. market share is low in this sector, taking only 3.27% of the market – which is less than eight other competitors.
- Over the past ten years, the U.S. share has been shrinking drastically, from the highest 28.71% in 1999 to the current of 3.27% in 2008.
- The Moon Cake Festival, or the Mid Autumn Festival, could be a good opportunity. High quality, healthy alternatives with nutritional benefits are good selling points for U.S. ingredients suppliers to enter the mainland moon-cake industry. Dried or processed fruit ingredients, nuts, as well as light flavored cheese have good potential for this market since they add health and nutritional benefits. Various high quality U.S. ingredients such as cranberries and almonds have been creatively mixed with conventional lotus seed puree or multiple nuts in some recipes.

<p>Preserved food (20) Import value: \$300.626 mil</p>	<ul style="list-style-type: none"> • U.S. \$106.280 mil – 35.35% • Brazil \$86.976 mil – 28.93% 	<ul style="list-style-type: none"> • The competitors in the fruit and vegetable juice are more competitive in price. Average price for Brazilian products is 	<ul style="list-style-type: none"> • Cheap in price but relatively lower in quality.
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		\$2.08/Kg, and Israeli \$1.82/Kg, but the U.S. is \$2.30/Kg.	
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- The US exported the highest value of preserved food to China in 2008, ahead of Brazil. But over the past few years, the two have been competing for the champion in this sector.
- Brazil has been dominating and expanding their share in the biggest sub-sector of fruit & vegetable juice (2009) with a share of 61.08%. The U.S. is only the third after Israel with a share of less than 8%.
- The U.S. takes the biggest share of over 46% in the second largest sub-sector of other fruit and nuts (2008), where Brazil accounts for only 10%.
- The U.S. takes the lead in the third largest sub-component of other prepared vegetable, frozen, with a dominant share of 82%. The follower, Canada, carries a share of only 11%.
- The U.S., apart from the frozen vegetables and fruits, should have a potential to explore its share in the fruit and vegetable juice.

Beverages (22) Import value: \$1,137.656 mil	<ul style="list-style-type: none"> • France, \$655.302 mil – 57.60% • United Kingdom, \$117.109 mil - 10.29% • Australia, \$61.481 mil - 5.40% • Chile, \$57.065 mil, -5.02% • U.S. \$33.768 mil - 2.97% 	<ul style="list-style-type: none"> • France is an early bird in the market. • Over the recent years, Australia and Chili are having large scale promotion campaigns and their sales have been soaring then. • Australia and Chili are competitive in price. • Some European countries are pouring their products to China with very low prices. 	<ul style="list-style-type: none"> • Lower quality and acceptable prices for common consumers.
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- The U.S. takes a share of only 2.97% in this sector, being the fifth after France, the UK, Australia, and Chile. France takes a dominant share of 57.6%, and continues their expanding.
- In the largest sub sector of ethyl alcohol (2208), The U.S. takes a mere share of only 1.39%, where the position of France is unmovable by taking nearly 75%.
- In the second largest sub sector of wine made of grape, the U.S. takes a 5% share. France is still the champion, but with a much smaller share of less than 40%. Australia, Chili and Italy also take heavy shares following France and ahead of the US.

Source: World Trade Atlas and USDA GAIN Reports

SECTION IV. BEST PRODUCT PROSPECTS

Figure 24: Category A of Best Product Prospects

Ranking	Product Categories	2003 imports (\$ mil)	2008 Imports (\$mil)	% 5 Yr. Avg. Annual Growth	Import Tariff Rates (%)	Remarks
•	Fruits and nuts prepared or preserved (2008)	12	96	51.57	Ranging from 5 to 30, depending on specific products.	<ul style="list-style-type: none"> In a long run, demand on this category is likely rise.
•	Pork (0203)	91	523	41.87	20 for fresh and chilled and 12 for frozen	<ul style="list-style-type: none"> With measures to regulate and protect the sector in place, China's pork imports may decline in 2009 from the previous years. However, increasing consumption could keep growth steady in future years.
•	Edible fruits and nuts (08)	495	1,237	20.10	Varies from 10 to 30, depending on different products and purposes	<ul style="list-style-type: none"> Falling prices on imports and strong domestic demand beefed up this sector. Tree nuts imports generally saw a growth of over 50%. The U.S. products should be able to further expand in this market.
•	Poultry (0207)	462	1,087	18.66	Generally 20, 10 or 5 for several items	<ul style="list-style-type: none"> Most U.S. products were chicken paws, followed by leg quarters and drumsticks, wingtips, chicken wings, turkey products and gizzards. Chicken paws are warmly welcomed in South China while leg quarters and

						<ul style="list-style-type: none"> drumsticks are consumed heavily in Northwest China. While growing supply of pork may reduce demands on poultry import, it is predicted that the overall imports are not likely to decline heavily due to increasing consumption.
•	Fish (frozen, not fillets) (0303)	1,195	2,736	18.02	10 or 12	<ul style="list-style-type: none"> China's processed seafoods are mostly exported to the United States, Japan and EU. However, stricter inspection standards in the U.S. and Japan market cools off China's exports, which may in turn cool off the U.S. export to China.
•	Milk, cream, concentrated or sweetened (0402)	217	401	13.07	10	<ul style="list-style-type: none"> This sector is regarded as have very good potential in the coming years.
•	Fruit and vegetable juice (2009)	75	126	10.93	Varies from 7.5 to 30	<ul style="list-style-type: none"> The U.S. is only the third after Brazil and Israel with a share of less than 8%.

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

Category A is a collection of products present in the market which have seen good sales already but are potential to sell better. They are ranked in order of 5 year average annual growth rate, which provides an indication of their potentiality in the market.

Figure 25: Category B of Best Product Prospects

Ranking	Product Categories	2003 imports (\$ mil)	2008 Imports (\$mil)	%5 Yr Avg. Annual Growth	Import Tariff Rate (%)	Remarks
•	Wine (2204)	33	381	63.11	14 for sparkling	<ul style="list-style-type: none"> One of the most rapidly growing

					wine, 20 for others and 30 for other grape must	and potential sectors.
•	Beef frozen (0202)	1	10	58.49	25 for carcasses and half carcasses and 12 for other cuts with bone in	
•	Ethyl alcohol (2208)	92	658	48.21	10	<ul style="list-style-type: none"> This sector has been growing steadily over the past years. The trend should extend into the future years as well.
•	Cheese and curd (0405) and Butter, oils from milk (0406)	10	59	42.62	10, 12 or 15, depending on specific products	<ul style="list-style-type: none"> The market is not huge yet, but has considerable potential.
•	Baking related (19)	148	717	37.10	Varies from 10 to 30	<ul style="list-style-type: none"> This sector deserves extra attention.
•	Whey (0404)	100	313	25.63	6 for whey and modified whey and 20 for others	<ul style="list-style-type: none"> The U.S. has successfully expanded its share of whey export to China. This sector could be further expanded.

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

Category B hosts the products which are not present in significant quantities but have good sales potential. Similarly, they are ranked in order of 5 year average annual growth rate to provide an indication of their potential.

SECTION V. POST CONTACT AND FURTHER INFORMATION

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^[1]The Status Quo of China's Food Quality and Safety by the State Council, 2007.