

USDA Foreign Agricultural Service

# GAIN Report

Global Agricultural Information Network

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Food Processing Ingredients Sector

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**Report Highlights:**

China's GDP climbed back to double digit growth in 2010, and the gross sales value of the food industry in 2010 reached a record RMB5.4 trillion, or \$812 billion. Although growth at this pace is unlikely to continue indefinitely, opportunities for U.S. products will continue to grow due to factors including; the rising demand for increasingly sophisticated ingredients; growing consumer emphasis on healthy ingredients; continued appreciation of the RMB; and instability in the price, availability and quality of ingredients from domestic suppliers.

**General Information:**

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### EXECUTIVE SUMMARY

This annual report reviews the development of China's food industry in 2010 and the first half of 2011, and examines trends and prospects of the industry for the second half of 2011.

In 2010, China brought its Gross Domestic Production (GDP) growth back into the double digits, 10.4 percent, after falling to 9 percent for two years in a row following the outbreak of the global financial crisis. This was achieved through various measures, including the Four Trillion Stimulus Plan (\$588 billion), in an effort to transform China's economy from one based on exports to one driven more by domestic consumption.

China's food industry continued the 30 year trend of rapid growth, with gross sales values in 2010 reaching nearly RMB5.4 trillion (\$812 billion): 22 percent higher than the previous year. By the end of 2010, the number of large food processing companies increased by 2,000 to exceeded 41,000. Food exports in 2010 climbed to \$41.1 billion, a 26 percent increase over 2009; and food imports reached \$21.6 billion, an increase of 45.4 percent compared to 2009.

2011 has proven to be somewhat more difficult: from the start of the year, the Consumer Price Index (CPI) started to climb, jumping by a record of 6.5 percent in the middle of the year. Rising labor costs, coupled with weaker export markets and overall rising prices hit small-sized companies in coastal area, with a growing number of bankruptcies. The final GDP numbers for 2011 are expected by many sources to fall back below 10 percent.

Amidst this hardship, rapid growth in the food manufacturing industry is expected to moderate somewhat as higher food prices and labor costs, increased regulation and increasing sophistication among manufacturers reduce margins and increase competition. Despite this, growth is likely to continue as consumers continue to demand more heavily processed foods to save time, and are increasingly willing to pay for attributes such as increased safety. There remains considerable room for consolidation and increased efficiency within the industry. In some respects, this may create more opportunities for U.S. agricultural products, as rising ingredients costs and appreciation of the RMB narrows the gap between imported and domestic products. An obvious example is in China's imports of U.S. swine meat, which have increased 1,400 percent in 2011 to 158,000 metric tons.

The prospects of U.S. food ingredients can be roughly categorized as the follows, in order of their potential in the China market:

- **Strong demand:** Those products that are not produced in China but have a large market, or which are produced in China, but where the U.S. product boasts a significant and widely recognized price/quality advantage.
- **Good prospect:** Ingredients that have developed a significant price advantage recently, but which are still not widely marketed in China.
- **Potential prospect:** Products which are not currently marketed in China, but for which domestic demand is growing, while production remains flat to declining.

- **Conditional good prospect:** Products that needs heavy marketing activities in China or efforts in closing price gaps.

In general, China is an immense market and able to accommodate more imported food ingredients than it currently does. A substantial number of ingredient products are either not available domestically in significant quantities, or suffer from significant quality issues relative to price.

*Note: RMB is converted into U.S. dollars at prevailing rates in effect during data collection periods. In 2008, \$1 = RMB6.95; in 2009, \$1 =RMB6.83; and in 2010, \$1 = RMB6.77.*

## SECTION I MARKET SUMMARY

### 1.1 Market Overview

In 2010 China made a critical contribution in stabilizing the world economy. After two years of single-digit GDP growth, China moved back above 10 percent. Growth in food manufacturing was even more impressive.

#### Food industry 2010 at a glance:

|   |                                   |
|---|-----------------------------------|
| Gross sales value*:                       | RMB5.4 trillion, or \$812 billion |
| % increase than 2009:                     | 24                                |
| % of gross industry output value:         | 9                                 |
| Number of sized firms**:                  | 41,867                            |
| Number of total firms:                    | About 500,000                     |
| Firms above RMB10 billion in sales value: | 27                                |
| Food exports value:                       | \$41.4 billion                    |
| % increase than 2009:                     | 26                                |
| Food imports value:                       | \$21.6 billion                    |
| % increase than 2009:                     | 45.4                              |
| Number of employee:                       | 6,560,000                         |

\*. *Not Sales Value, but Gross Industry Output Value, is discussed in China Statistical Yearbook. Sales Value here equals to 98 percent of Gross Industry Output Value based on the indicator of Proportion of Products Sold. All Sales Values hereafter are calculated in this way.*

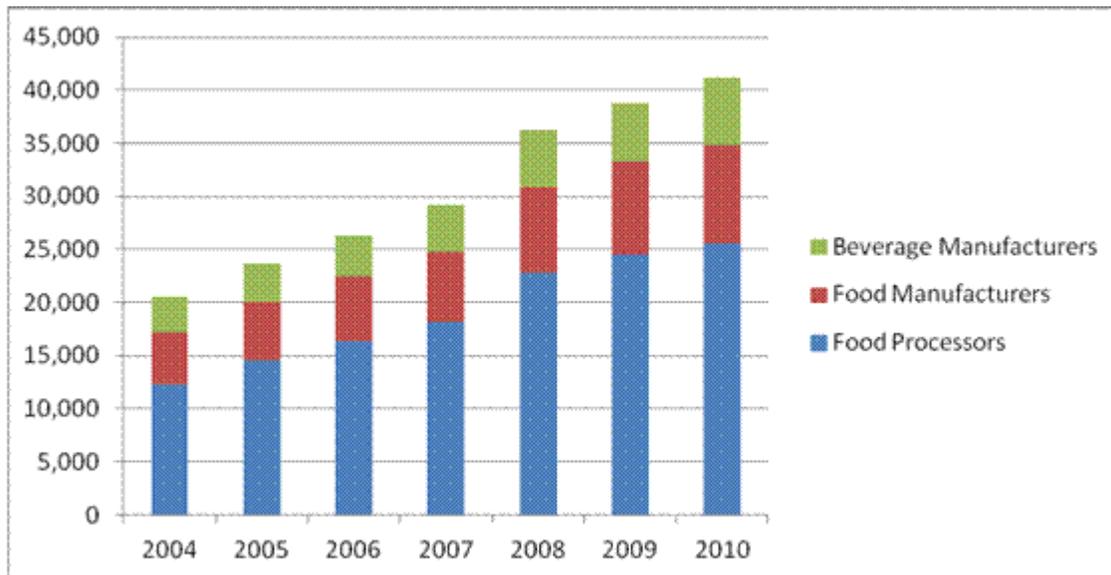
\*\* *Firms with annual sales revenue of less than RMB5 million (\$740,000).*

#### 1.1.1 Market Growth

Development of the industry is best illustrated by four indicators: number of firms; gross sales value; output value growth of food industry against agriculture; and growth of manufacturing sectors against the processing sector.

#### Number of firms

**Figure 1: Growth of Number of Firms in Food Sectors 2003 – 2010**



Source: China Statistical Yearbook, 2004-2011

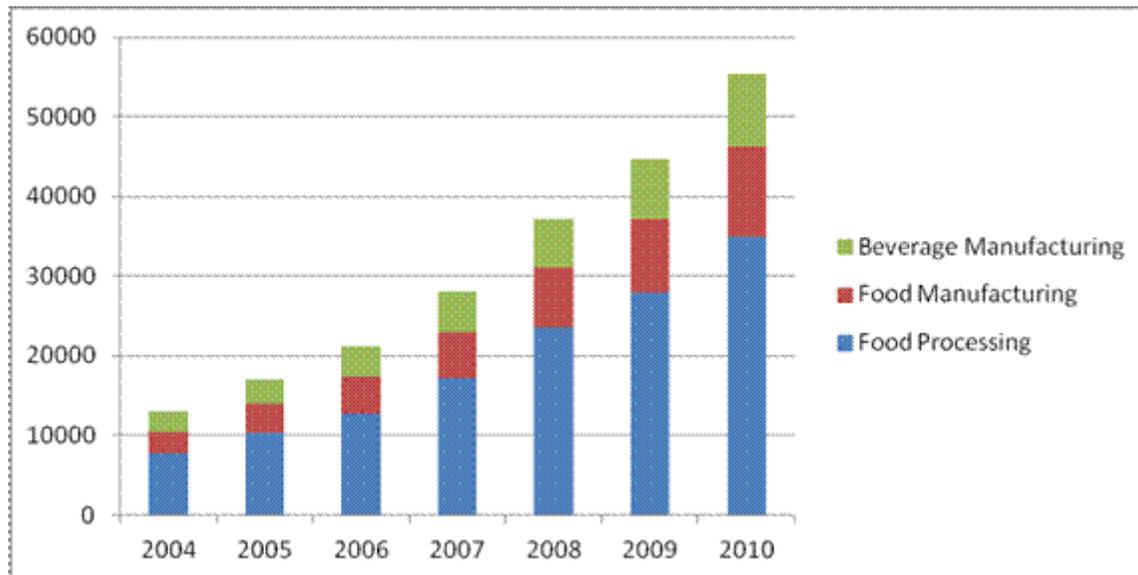
\* Statistics are only available for firms with annual sales revenue in excess of RMB 5 million

By end 2010, the total number of food processors and manufacturers reached 41,135, almost doubling in the six years since 2004, and equivalent to an annual growth rate of about 14 percent. The reason behind this fast growth is two-fold: first, the rising demand for processed food products; and second, it is relatively easier to establish a food operation due to the low entry requirements on capital investment and technological abilities.

This rapid growth, however, is likely to slow down in the coming years. Multiple factors are likely to contribute to this, including policy and costs restraints. The Food Safety Law effective from June 1<sup>st</sup> 2009 is a good example on policy side: it has set higher entry bars than ever for food operations, and regulation is only likely to become tougher in the future. Costs concerns include high rising raw materials costs and labor costs.

### **Gross sales value**

**Figure 2: Growth of Sales Value in Food Sectors 2003- 2010 (RMB100 million)**



Source: China Statistical Yearbook, 2004-2011

\*Sales value comes from 98 percent (Proportion of Products Sold) of RMB55,432 (Gross Industry Output Value)

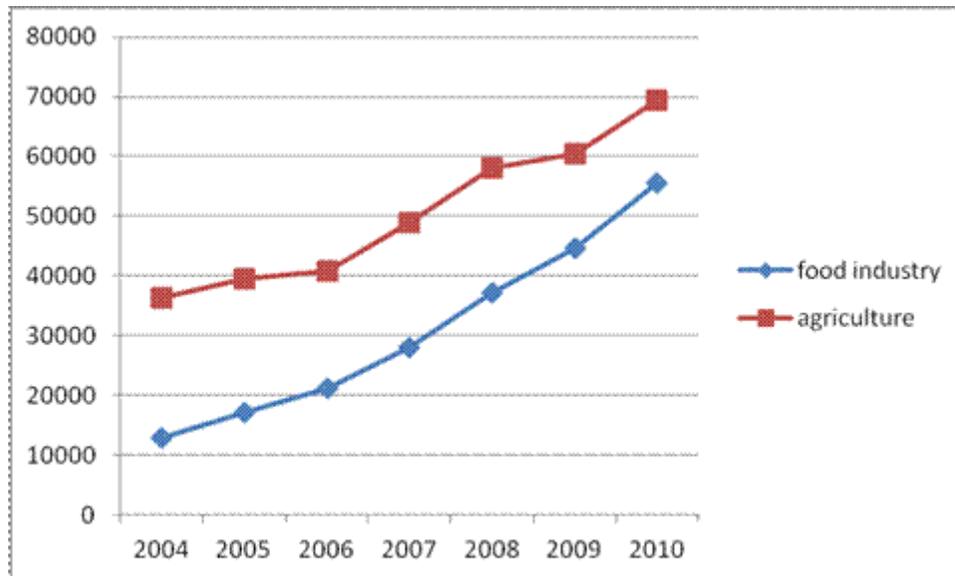
The global financial crisis in 2008 appeared to have minimal impact on China's food industry, and in 2010 sales values reached RMB5.4 trillion, about five times of the value in 2004, representing an average annual growth of about 25 percent. RMB5.4 trillion equals to about US\$800 billion, accounting for about 9% of China's gross industry output value. This may actually be larger, noting the fact that the data above do not include firms with annual sales revenue of less than RMB5 million (\$740,000). When this part is added, it is estimated that the total industry sales value in 2010 could be as high as RMB6.5 trillion (\$960 billion).

Although both sales revenue and firm numbers increased substantially, it is easy to see that sales revenue growth far outpaces growth in firms, indicating that manufacturers are growing in size or consolidating, and it is expected this trend would continue into the coming years.

### **Growth of food industry in comparison with agriculture\***

\*. Agriculture here refers to agriculture, forestry, animal husbandry and fisheries

**Figure 3: Growth Rates Comparison between Agriculture and Food Industry 2004- 2010 (RMB100 million)**



Source: China Statistical Yearbook, 2004-2011

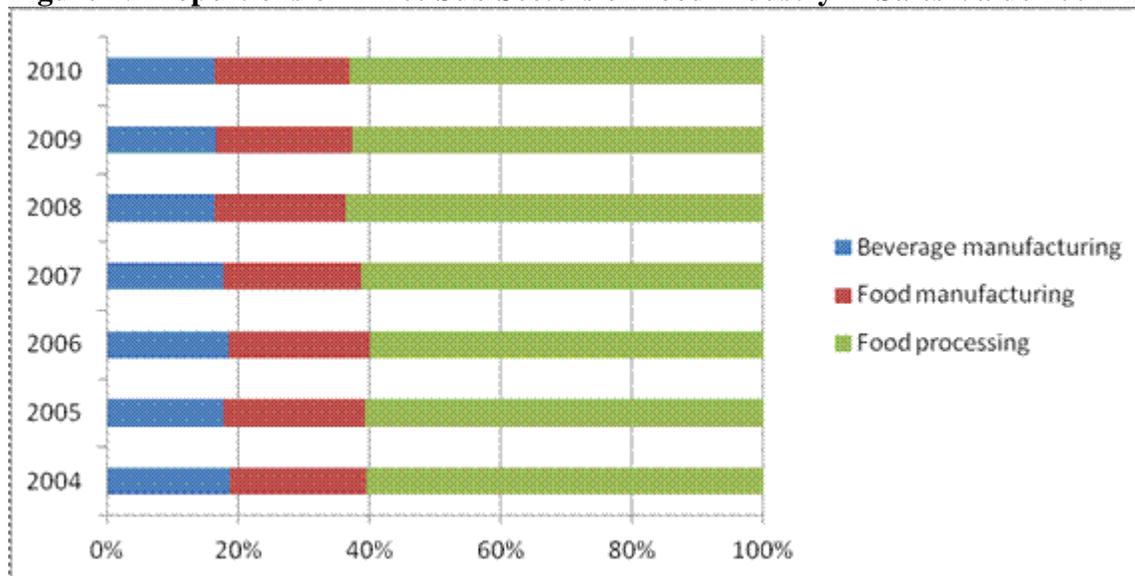
Dating back to 2004, food industry was only about one third the size of agriculture in output value. While agriculture has grown steadily, food industry has grown rapidly and considerably narrowed the gap between the two. Presently, food industry is about 80 percent the size of agriculture. Provided the two keep their current growth rates, food industry is expected pass agriculture in output value by 2013, reaching roughly RMB9 trillion in gross output.

### **Manufacturing sectors against processing sector**

Official Chinese statistics separate industrial food production into three categories:

- **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 4: Proportions of Three Sub Sectors of Food Industry in Sales Value 2004- 2010**



Source: *China Statistical Yearbook, 2004-2011*

Despite its huge size and rapid growth rate, China's food industry remains more focused on primary processing than in-depth manufacturing, with primary processing actually gaining slightly in recent years. As a result, the ratio of manufacturing output value against processing sector has remained at 1:2, far behind the average ratio of 3:1 in developed countries.

Nevertheless, China's development is different, emphasizing size first and quality second. It appears likely that the development of China's in-depth food manufacturing industry is just getting started, and that future growth is likely to shift away from primary processing and into manufacturing.

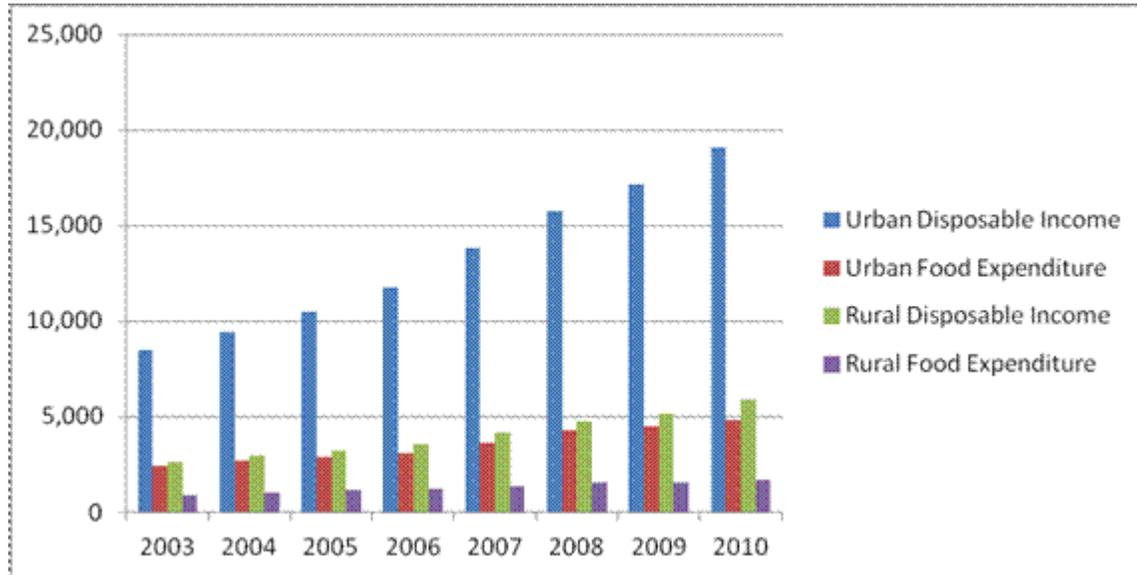
### **1.1.2 Driving forces**

Among all the forces that contribute to China's food industry, disposable income and urbanization are the most important. In addition, food safety has also played a big role recently by lifting demand for high quality food ingredients.

#### **Increasing disposable income**

Disposable income is the engine driving demand for processed foods, rising at a rapid pace over the past 30 years.

**Figure 5: Per Capita Income and Food Expenditure in China 2004-2010 (RMB)**



Source: China Statistical Yearbook, 2004-2011

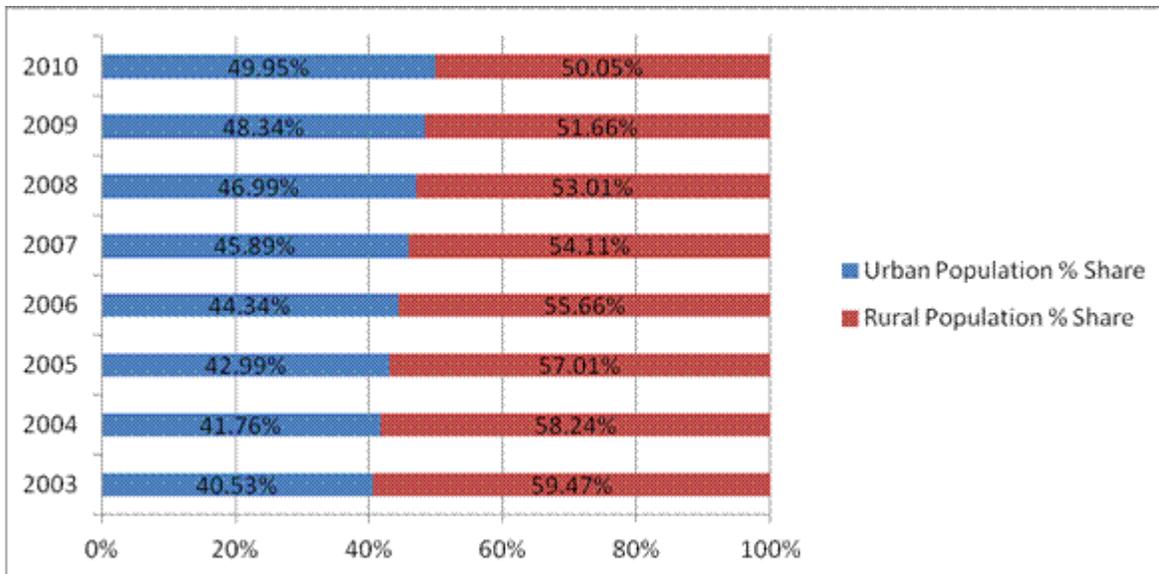
In addition to fueling the overall growth in food expenditures, continued income growth is likely to contribute to a middle income consumer boom in urban areas. Middle-class consumers are quickly becoming more sensitive to quality issues in food, and driving growth in food imports. The number of urban households earning more than US\$5,000 a year is estimated to grow annually by 24 percent, creating tens of millions of new consumers for high-value and imported food.

However, it has to be noted that real disposable income growth is slowing down due to continued rising prices. The CPI for China in 2010 was 3.3 percent, which cut the actual income growth down to about 8 percent. Provided that 2011 disposable income growth remains about 11 percent, the actual disposable income may be pulled down to about 6 percent, based on the estimated CPI of 5.5 percent in 2011.

### **Urbanization**

The Chinese government has been supporting urbanization for years, in hopes of generating more jobs to absorb labor freed by modern agriculture and losses in arable land. As a result, the rural population has been dropping as urban population climbs.

**Figure 6: Urbanization Trends 2003-2010**



Source: *China Statistical Yearbook, 2011*

By end 2010, about 50 percent of China's population was urban. Over the past seven years, the rural population has dropped by 1.3 percent, or by about 10 million a year. At the same time, the urban population jumped by 3 percent or around 15 to 20 million a year. With urbanization deepening, the traditional preference for fresh food and wet markets is giving way to processed food and supermarkets. This has had profound implications for China's demand for processed foods. This trend is likely to slow in the coming years: labor shortages in South China and East China, rising labor costs across China indicate that the seemingly endless labor supply from rural areas is beginning to dry up.

### **Food safety**

As food safety scandals make daily headlines in China's media outlets, the issue of food and product safety has become a critical area of concern for government leaders, industry associations, food manufacturers, and consumers. Safeguarding the food supply is of paramount importance to the government of China. However, while China is paying greater attention to strengthening food safety legislation and enforcement, according to official statistics by the Supreme People's Procurator, the top food safety prosecuting agency, 220 suspects were accused of manufacturing and selling food unfit for human consumption in the first quarter of 2011 alone, with 113 prosecution in 65 cases. Additionally, in June, 2011, the China Supreme People's Court authorized use of the death sentence for those (individuals or companies) found guilty of food safety violations that result in human death or serious injury. Implementing this draconian measure to assuage food safety crimes demonstrates the government's frustration at their inability to enforce food safety regulations.

In an effort to support China's efforts to improve food safety practices and enforcement, the United States Food and Drug Administration and the Foreign Agricultural Service (the diplomatic arm of the United States Department of Agriculture) recently conducted a Food Defense Awareness Roadshow in Beijing, Shanghai, and Guangzhou. In early 2011 United States implemented the Food Safety Modernization Act, securing the safe food supply both domestically and internationally. In addition to advising foreign exporters of the regulation and its requirements, this event helps foreign regulators understand the U.S. approach to food safety, and how it works with modern food supply chain systems,

with the potential for adapting some of these approaches to support their own food safety efforts. Such efforts are also likely to increase the appeal of imported ingredients.

### **1.1.3 Threats**

A number of different factors have raised concerns that the Chinese economy may face greater difficulty in the future, possibly even an end to the era of rapid growth. Although growth appears unlikely to end, it is clear that these factors will have a substantial moderating effect on China's future expansion, and will likely affect the food manufacturing industry.

#### **Rising food ingredients prices**

Although food prices are rising globally, the problem in China is amplified by the effects of unrestrained speculation. Starting with mung beans, followed by ginger, apples, peanuts, pork, and so on, a whole list of agricultural products have experienced price increases and fluctuations ranging from 20 - 30 percent to as high as 100 percent or more over the past two years. This has made it extremely difficult for food manufacturers to control costs, and is having a particularly strong impact on smaller companies that have less bargaining power. The impact for imported ingredients is likely to be mixed. Although import prices tend to be more stable, many manufacturers have sufficient capital on hand to invest in their own ingredient production, and price instability is increasing their incentive to do so. This trend is also being influenced by food safety concerns, as large food manufacturers seek to ensure quality by taking ownership and directly controlling the manufacture of their primary inputs.

#### **Soaring labor costs**

As noted earlier, labor shortages and consequent increases in wages have gone from being a seasonal issue in South China to becoming a more nationwide problem throughout the year. Food manufacturing has been particularly dependent on low-cost unskilled labor and salary requests are increasing by as much as 30-50 percent per year in the past two or three years. Shortages of low-cost labor are causing many operations to limit production.

#### **Excessive food safety costs**

A continuous drumbeat of food safety scandals in the local papers have made the Chinese government extremely sensitive to the issue. In response, a wide range of new measures have been introduced to help ensure safety. These are, however, adding considerably to the cost for manufacturers. Dairy has been particularly hard hit. The new dairy food sector policy effective from April 1<sup>st</sup> 2011 has greatly lifted standards for producers. As a result, it drove about half of dairy food makers out of the market, and left the survivors bearing an additional RMB1 million per month for cost of quality checks and improvements to testing and inspection equipment. For other food sectors, manufacturers have to be extremely cautious in selecting raw materials, in most cases, purchasing more expensive ingredients, to make sure their products are safety problem free, this has imposed substantial additional costs on them.

In general, it is likely that the breakneck pace of growth in this industry will slow somewhat, and that a good deal of industry consolidation will take place as nearly all of these factors have a disproportionate

impact on the smallest manufacturers.

## **1.2 Some Important Food Sectors**

Sectors that may relate to U.S. agricultural products involve frozen food, prepared meats, snack food, bakery and dairy products.

### **1.2.1 Frozen Food**

Frozen food is a fairly broad category that includes frozen breads and dumplings, prepared meats, ice cream and so on, although consumers primarily see this category as being comprised of frozen dumplings and breads.

In ten years China's frozen food industry has grown from one overwhelmingly dominated by mom-and-pop stores into a massive, highly modern industry accounting for well over \$10 billion in annual sales. The industry is centered around the city of Zhengzhou, home to China's two largest frozen food manufacturers, San Quan and Syneer. Each company commands close to ¼ of the market, with roughly 500,000 metric tons in current manufacturing capacity and gross sales of RMB3 billion. Both are adding new manufacturing capacity, and San Quan expects to triple its output within the next five years.

These manufacturers are a far cry from their homespun antecedents. They are large corporations whose products are a household name across China, and who have brand names and reputations to protect. San Quan currently exports to twenty different countries, and could easily export more if domestic markets didn't demand their full attention. With famous names and large investments in their product lines, these companies have a powerful interest in guaranteeing the quality of their products – including the ingredients they use to manufacture them. Laboratory facilities are extensive and include the latest gas chromatography and other equipment. This need to ensure quality and safety, along with the need to innovate in order to stay ahead of me-too manufacturers, is driving a keen interest in new ingredients, including imports.

China's frozen food industry revolves around several traditional foodstuffs: vegetable and meat dumplings that are boiled, and sweet rice flour balls traditionally stuffed with black sesame sauce. Other products include hun dun (won ton), noodles and frozen steamed breads (mantou). The principal ingredients are simple: wheat flour, pork, fresh vegetables. However, as competition grows, manufacturers are seeking ways to distinguish themselves by offering new tastes and varieties. San Quan is already producing a line of fruit-flavored tangyuan (which traditionally use sweet sesame fillings), including one that uses blueberry fillings imported from the United States.

### **1.2.2 Prepared Meat**

Prepared meat, after quick frozen dumplings and breads, is also a rapidly growing food sector. It, too, is built on consumers' demands for convenience has been boosted tremendously by that increasing tempo of modern urban life. Prepared meat foods can be categorized into three sub sectors, depending on production and preservation processes: fresh prepared meats; prepared meats in vacuum packages; and frozen prepared meats.

Fresh prepared meats are generally high in quality but short in shelf life, limiting them primarily to regional markets. Throughout China, each region (in some cases each city) has its signature brands. Barring a rapid and dramatic improvement in cold chain logistics, this market is likely to remain heavily fragmented for the time being. Most companies that have successfully expanded beyond one region have done so by establishing new manufacturing facilities in different regions, and adapting their product to local tastes, rather than attempting to ship from the original plant to the target market.

Prepared meats in vacuum packages have been on the market for about twenty years, with the main products type being different kinds of sausages. Sausages have helped built many of China's leading brands, including Shineway, Topin and Yurun. These brands are not only sector leaders, but also giants in China's food industry with annual sales boasting RMB30 – 50 billion. However, most of these companies have focused substantial effort on building their own swine farming and internal supply facilities and have little demand for imported meat products.

The third subsector, frozen prepared meats, is where the primary interest in imports appears to be. This is the most recent part of the industry to develop, having started roughly ten years ago, growing to RMB12 billion in sales by 2010. The growth rate of the sector is 35 percent over the past decade, about 10 percent higher than the overall average for food industry. This extremely fast growth is expected to continue for the near future, as the industry remains relatively underdeveloped. The main product types are meat ball or fish ball, for hot pot use or daily cooking, with some variations in ingredients, sizes, and flavors etc.

The center of frozen prepared meats is in Shandong province, hosting industry leaders such as Longda, Huifa and Jiashibo etc. Huifa for example, has a history of only 10 years, but has grown its sales to RMB760 million in 2010, boasting an annual increase of 200 percent over the last 6 years. Jiashibo, Huifa's competitor in the same city and having the same history, is experiencing similar growth.

Unlike the giants in the sausage sector, the main manufacturers in the frozen prepared meat sector have not pursued a strategy of vertical integration, leaving them free to source raw materials as they see fit. As they continue to expand, however, sourcing will become an increasingly important issue for them. A second characteristic of this industry sector is the nature of the ingredients demanded: production typically demands not lean muscle cuts, but high-fat parts such as pork collars and bellies, feet and offals. These parts are typically less widely utilized in the U.S., with significant exportable supplies.

### **1.2.3 Snack Food and Chocolate Candy**

Snack food is a top three sector in terms of growth rate among all food industry sectors, only after frozen food and health food. There are no official statistics on the size of this market, but it is estimated to be as large as RMB100 billion in sales, with an annual growth rate greater than 25 percent.

The snack food sector is characterized by relatively low entry costs but relatively high failure rates. Competition is high, innovation vital, and profit margins thin. Manufacturers try to innovate their products in shape, color, taste, mouth feel and packaging, but have historically avoided imported ingredients out of cost concerns.

The basic ingredients utilized in the snack food sector are fairly simple: wheat flour, rice, seafood, flavorings and seasonings, colorings, fruits, nuts, and other regular agricultural products, many of which can be domestically supplied. The largest exception are for tree nuts and certain fruits that are not widely available domestically. The largest sub-sector using these products, apart from the snack roasting sector, is chocolate candy. Demand is, surprisingly, higher in the mid-low end of this sector, as competition is especially fierce, and imported ingredients can help manufacturers add value to their product line and gain an edge on the competition.

Mid to low end chocolate candy manufacture is largely clustered in the city of Tianjin, with a history dating back 50 years, when Tianjin, Beijing and Shanghai dominated. Chocolate manufacturing in the other two cities declined in the 1980s as their economies boomed and higher-value industries pushed out these relatively low margin manufacturers. The industry in Tianjin, viewing this as an opportunity, purchased much of the equipment and know-how shed by Beijing and became the number one chocolate candy center in terms of production in China. By the 1980's and 1990's Tianjin's Dagang district alone boasted over 200 manufacturers, but numbers have since declined in the face of competition from high-end imports from Dove, Hershey and Ferrero.

Currently, there still exist about 70 chocolate candy producers in Tianjin, producing about 80 percent of chocolate by volume in China. They are mostly small to medium in size, and the bigger ones have a sales volume of ranging from RMB20-50 million a year, with the largest one reaching about RMB100 million a year. Unlike the high end brands, the majority of Tianjin's chocolate products are not real chocolates, as their major ingredients are cocoa butter substitutes, rather than cocoa butter.

This industry is in decline, having lost the first tier city markets to international competitors, and lacking the margins to upgrade facilities or invest in product development. Rising ingredients costs are adding to their difficulties, with most ingredients seeing price jumps of 30-50 percent. Ingredients suppliers that can demonstrate significant product improvements at minimal cost through the use of their products are likely to find a very receptive audience in this industry.

#### **1.2.4 Baking industry**

##### **Strengths**

Young, middle-class consumers are changing the complexion of China's traditionally conservative baking industry, creating new opportunities for imported ingredients. Key factors involved in this change include:

- Consumers pay greater attention to nutrition and food safety given rampant food safety irregularities uncovered by the media.
- Inflation has driven the cost of domestic food items up by up to 20-25 percent in the last two years, reducing the difference in pricing between domestic and imported foods. A clear-cut example is with raisins. The price in local high-end retail outlets for branded U.S. raisins 150g sells at \$1.7, while Guangdong grown raisins sell at \$1.2, and Xinjiang raisins sell at \$1.6. The

price difference is not noticeable to the average consumer.

- Retail sales of baking products such as bread, pastries, and cakes have increased from RMB 0.6 billion to 1.2 billion in the last decade with the estimated amount expected to reach 11.1 billion by 2015. This indicates that consumer demand for bakery products is growing at a faster pace than expected only two years ago, as 2010 per capita consumption at 5.1 kg was nearly double the 2008 figure. There is still plenty of room for growth: by comparison, in 2009, average per capita consumption of baked goods was 36.4kg in Britain, and 25.4kg in the United States.

### Health/Natural ingredients

Worthy of separate note is the growing trend toward natural ingredients, driven by an increasing awareness of health issues. Consumers are seeking functionality from their foods, including bakery.

Baking products containing dried fruit and nuts, cheeses, meat or other high value or high protein ingredients are popular choices for urban consumers. This trend is supported by higher disposable incomes among middle-class consumers, who are turning to bakery items as a source of snacks, breakfast, dessert, dinner and sometimes lunch (in this order).

The consumption of U.S. baking ingredients by the trade, as a whole, have periodically increased in South China in an average of 10-percent increments over the past six years. U.S. almonds, raisins, cranberries, blueberries, and walnuts are among the most popular and widely used by China's baking industry, while pistachios and pecans, are in the upper echelon as far as higher-end bakery ingredients, used by restaurants and five-star hotels and have proven to add premium value to the restaurant's reputation, profitability and quality of goods.

More than a quarter of consumption is from retail bakery chains, fueling double-digit growth over the last four years across China. In South China, vertically integrated bakery chains such as Sunmile in Fujian, Donghaitang in Guangzhou, Bread Talk in Shenzhen have parlayed a strong presence in Taiwan or Hong Kong into a presence on the mainland. Another example of the emerging players is the Guangzhou Crown Maliao Bakery Chain, which has expanded from 80 stores to 107 stores in Guangzhou in a matter of three years; as well as the 85°C bakery, a well known Taiwanese bakery chain headquartered in Shanghai and making inroads in South China.

Perceptions of bakery items are changing, as they become increasingly regarded as a nutritious and quick alternative to a snack or meal by most middle class consumers. Chinese consumers have become more health conscious and aware of natural and nutritional ingredients. Consumers born in 1970-80s are now purchasing baked goods for their family members, and with continual education advertising the benefits of U.S. ingredients ingredient, suppliers can reinforce the image of U.S. products have in the South China market.

### Weaknesses

- The bakery industry is highly fragmented because of product freshness requirements and uneven development of the industry, as well as subtle consumer taste differences in each province. Therefore, each area has its own dominant bakery chains.
- Limited knowledge by baking professionals on the use and application of U.S. baking

ingredients, and low consumer awareness of the wide variety of U.S. bakery ingredients and their benefits remain as the single largest constraint.

- Insufficient promotion management is another key shortcoming for U.S. bakery ingredients in China. Most of the marketing schemes target traders and media, a slightly narrow approach that is not particularly effective in building demand. Increased focus on end users such as bakery chains, hotels and restaurants would be more effective.
- Cold chain remains a major barrier. In 2010, China established a national cold chain standard, however at present only 15 percent of food, meat and vegetables are transported and stored in refrigerated facilities. Further development of China's cold chain logistics will reduce losses to spoilage during transportation and storage, and will hopefully raise food safety standards. Moreover, improved cold chain logistics will increase the availability of U.S. ingredients with shorter shelf-lives such as cheese and fresh fruit.

### **Opportunities**

- Limited competition

This year, U.S. bakery ingredients are expected see an increase in demand, not only as markets in second and third tier cities kick in, but also as a result of limitations on export competitors. China imposed a series of restrictions on Japanese agricultural exports out of concerns over possible radiation contamination; likewise Taiwan's DEHP scandal resulted in a number of barriers being imposed against Taiwanese processed food and beverage exports to China. Traders and retailers that imported from Japan and Taiwan have diverted to other countries. However with recent e coli outbreaks in Europe, the U.S. may be in a position to strengthen its market share. Additionally, the rise of the Australian dollar has also benefited the competitiveness and sales of U.S. bakery ingredients in China. In 2010, consumption of U.S. dried fruit and nuts by the baking industry grew by 12 percent. Demand for better quality ingredients is promising for U.S. suppliers.

- Fresh baked products are now welcome

Unpackaged/fresh bread remained the fastest growing product category, with retail value growth of 9 percent in 2010 reaching RMB8 billion, according to Bakery Industry Association website statistics. More Chinese consumers, especially youth, prefer to consume bread for breakfast and unpackaged/fresh bread is often perceived as being as tasty as these products (see also FAS/China report on "The Westernization of Chinese Breakfast").

- Urbanization of second tier cities

Supermarkets and convenient stores growing access to second tier city markets has driven the sector's growth, helping bakeries to establish a foothold in marketing and expanding into these promising markets. For example, are the bakery chain Maxim's supplies 7-11 convenient stores, and Queen's has a counter in Jusco supermarkets. Meanwhile, high-end bakeries and chain stores are eager to differentiate themselves from competitors, and one focus of their strategy is to improve product quality

and innovation, creating ample opportunities for high quality U.S. ingredients.

- Bakeries turn to e-commerce to save costs

The convenience of the Internet is leading more consumers to turn to online businesses in China. With the booming cyber economy, people are finding that doing online business is cheaper and less time-consuming. The bakery sector is among the businesses capitalizing on this trend, and includes ebeecake, 21cake, and Waffleboy in the North, Migo in the South.

Waffleboy is a pioneer in the online cake business, opening in January 2001 in Beijing. Migo, the first online cake ordering business in Guangzhou, cooperating with nine local bakery outlets and provides catering service to all districts in Guangzhou including suburbs.

Though traditional chain stores remain the mainstream purchasing outlets, the sector's sudden growth is spawning a wide range of different operating models that will strengthen their presence as a whole. Western-style bread and cakes have become daily necessities for many urban consumers, and the bakery industry is undergoing a change. With fierce competition in a new market, operators must rely on quality ingredients to keep consumers satisfied and returning to their outlets. Value and convenience have become the top priorities for China's urban consumers, with price playing lesser role in many purchasing decisions.

### **Recommendations**

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

- Continued education to both bakers and consumers on the ingredients benefits
- Launching technical trainings or demonstrations to instruct local chefs the proper usage and application of U.S. ingredients in a creative way.
- Work with Chinese bakers to develop recipes that suit the local palette and elevate the reputation of the establishments.
- Facilitate in-store promotions to enhance U.S. ingredient branding as well as encourage new products that utilize U.S. ingredients via chain promotions or/and other periodic training programs throughout China and in particular in major cities.

## **1.2.5 Dairy Sector**

### **Market size**

The Chinese dairy market is growing rapidly. According to Euromonitor, total dairy sales in China reached \$ 27.432 billion in 2010, an increase of nearly 21.8 percent over 2008. The latest statistics show that dairy production during Jan-June 2011 increased by 10.9 percent over the same period in 2010. It is estimated that the dairy market grew another 11.6 percent in 2011.

**Figure 7: Retail Value of Dairy Markets (RMB million)**

|                            | 2006      | 2007      | 2008      | 2009      | 2010      |
|----------------------------|-----------|-----------|-----------|-----------|-----------|
| Dairy Products             | 119,194.2 | 137,705.5 | 143,821.4 | 157,944.1 | 175,235.6 |
| Drinking milk products     | 52,021.5  | 58,999.2  | 59,955.8  | 62,451.1  | 67,009.6  |
| Cheese                     | 476.2     | 559.6     | 668.7     | 779.8     | 916.4     |
| Yoghurt & sour milk drinks | 18,975.6  | 22,962.9  | 25,195.5  | 29,143.2  | 33,280.0  |
| Other dairy products       | 1,161.2   | 1,236.7   | 1,371.4   | 1,399.5   | 1,479.7   |

*\*Drinking milk products include fluid milk, flavored milk drinks and milk powder etc.*

*Source: Euromonitor (Exchange rate between USD and RMB: 1USD to 6.388RMB)*

China is the third-largest dairy producer in the world after India and United States, however per capita consumption is less than one quarter of the global average and even lower than many developing countries. Consumption rates vary widely across China, with consumption at its highest in urban areas but dropping to less than 10 percent of the urban total in rural areas.

In 2010, U.S. dairy ingredient exports to China exceeded 185,000 MT, falling by 2 percent compared to 2009 but remaining significantly higher than the 145,300 MT imported in 2008. The U.S. continues to be the market leader for whey products, with a market share of 52 percent. Among market access issues, China's request – starting in April 2010 – to renegotiate requirements for the U.S. health certificate is a major challenge to future expansion of U.S. dairy exports to China. Many suppliers postponed shipments to minimize risk and local buyers tended to switch to other suppliers.

In 2010, China's imports of milk powder rose 51 percent in volume to 514,000 MT, while value soared 92 percent to US\$1.9 billion. This growth is due to increased dairy consumption, solid demand for qualified infant formula and import prices that are competitive with local raw milk prices. U.S. milk powder exports increased in both volume and value; however at present the U.S. holds a minimal 3 percent market share, as New Zealand and Australia dominate this market segment.

In 2010, the value of sales of other dairy products, mostly condensed/evaporated milk, grew some 6 percent in 2010 to reach RMB1,480 million. The foodservice channel is likely to be the key focus of certain categories since most Chinese consumers do not know how to use dairy products like cream at home.

In late 2009 and early 2010 the melamine scandal continued to unfold. While all melamine-contaminated milk powder should have been destroyed, the media uncovered cases where it was mixed into new dairy products. The destruction of the original contaminated products was not well monitored in some areas. Consumer confidence in domestic dairy products has not yet recovered. Foreign suppliers aggressively tapped into the market - and "imported" came to be seen as a guarantee of food safety or at least "free of melamine."

### **Distribution channels of dairy products**

In China, nearly 80 percent of dairy products are purchased in retail channels. Supermarkets and hypermarkets have become the major outlet for all varieties of dairy products. For cheese products, yogurt and take-home ice cream, the supermarkets' role is even more important due to consumer's

confidence in their comparatively better cold chain facilities. Larger supermarkets and convenience stores also contributed to their increased share in the distribution channel.

Major manufacturers are also competing in the food service channel with specially designed brands. Brands such as Angli from Sanyuan, Yiran from Yili, LOOK from Bright Dairy, and Muge from Mengniu are designed to target the food service channel. Although profits in food service may be higher than in retail channels, manufacturers face high entrance fees from hotels and restaurants, and delayed payment. Hotels and restaurants normally pay after they sell the products. This has constrained the sales volume of the dairy products through food service channels.

The yoghurt bar is a restaurant format that has become popular with younger consumers in first tier cities. Competing with juice bars and ice-cream bars, yoghurt bars offer frozen yoghurt and yoghurt drinks of various flavors. These yoghurt bars are generally located in Central Business District (CBD) zones, catering to young white-collar workers. Their floor space is typically limited, and they have few seats, as most consumers choose take the products to their offices or homes.

### **Major product category trends**

#### **Fluid milk**

There are currently more than 2,000 companies in China involved in fluid milk production. Fierce competition has kept profit margins extremely narrow. At the national level, UHT milk holds about 70 percent of the market by volume, thanks to its availability in markets far from the manufacturing site and comparatively lower retail price. But in big cities where the cold chain infrastructure is better established, pasteurized milk occupies more than 70 percent of the market.

Inner Mongolia is the largest production area for fluid milk products in China, and is expected to account for 19.2 percent of total industry revenue in 2011. In the last two years, traditional pasteurized milk manufacturers such as Bright began to invest in the UHT milk sector heavily, while traditional UHT milk manufacturers such as Mengniu have built up farms and pasteurized milk production lines in areas adjacent to major consumer markets including Shanghai and Guangzhou. The previously heated debate about whether UHT or pasteurized milk was “more nutritious” or “safer” is no longer seen in the media.

UHT milk imports boomed in the wake of the melamine scandal, as parents sought to ensure a safe supply of milk for their children. New Zealand, though Fonterra, remains the largest foreign supplier, but German UHT milk is also present in substantial quantities. Organic UHT milk has seen considerable increase in sales, and U.S. UHT milk has made significant inroads in the past year.

**Figure 8: Sales Value of Fluid Milk 2006-2010 (RMB)**

|            | 2006     | 2007     | 2008     | 2009     | 2010     |
|------------|----------|----------|----------|----------|----------|
| Fluid milk | 52,021.5 | 58,999.2 | 59,955.8 | 62,451.1 | 67,009.6 |

*Source: Euromonitor*

#### **Cheese**

Mainland China and Hong Kong imported more than 37,000 MT of cheese in 2010, an increase of 22 percent over 2009. U.S. cheese exports reached 4,218 MT, a 52 percent increase over the previous year, yielding a market share of 11 percent. In 2010, local dairy manufacturers began to use U.S. bulk cheese for processed cheeses for the first time. Also, the number of U.S. cheese varieties available in the market has increased.

As a niche product, distribution channels for cheese are still limited. Supermarkets/ Hypermarkets sold 93 percent of the cheese in 2010. Cheese products are normally placed in a chilled case with other dairy products. Only a small number of brands are generally presented.

**Figure 9: \*Sales Value of Cheese 2005-2010**

| RMB million      | 2005   | 2006   | 2007   | 2008   | 2009   | 2010   |
|------------------|--------|--------|--------|--------|--------|--------|
| Processed Cheese | 402.81 | 476.16 | 559.61 | 668.67 | 779.83 | 916.44 |

*Source: Euromonitor (Exchange rate between USD and RMB: 1vs 6.388)*

The cheese market maintained robust growth in 2010. Although not a part of the traditional Chinese diet, the concept that cheese is a good source of protein and calcium has found its way into the middle class consumers' mind. One driving factor has been successful consumer education and the prevalence of Western food, another factor benefiting the market is the overall recovery of the dairy industry following the melamine scandal in late 2008. According to Euromonitor, the sales value of cheese in at retail grew by 17.5 percent in 2010.

Most of the cheese in China is imported. In 2010, New Zealand was the biggest cheese exporter to China, taking 47.65 percent of the import cheese market, followed by Australia (20.04 percent) and United States (12 percent). China also imports cheese from France, Italy and Denmark, as well as other countries.

The ratio between spreadable and unspreadable processed cheese was about 38.9 percent to 61.1 percent in 2010. Cream cheese dominated the spreadable processed cheese market. For unspreadable cheese, the most frequently available products are Mozzarella, Monterey Jack, Cheddar, and Parmesan cheese.

Leading domestic dairy companies including Bright Dairy, Sanyuan and Yili have all launched cheese processing lines. They have also run very successful consumer education programs. In 2010, Bright Dairy led cheese sales with 51 percent of the market, followed by Anchor and Pikifou. The top five brands occupy over 85 percent of the cheese market.

Many foreign brands are available in supermarkets in China. 11 U.S. cheese brands had entered the China market by the end of 2009. Brands including Land O'Lakes and Sargento performed very well. Other major import cheese brands are Kraft from various countries, Mainland from New Zealand, President and Cantorel from France, Bega from Australia, Emmi from Switzerland, Feta from Germany, Arla from Denmark, and Kerry Gold from Ireland.

Domestic cheeses are primarily purchased by health-conscious young parents who believe that cheese will improve the health of their children. Consumers of foreign brands are mainly foreigners living or traveling in China and returnees from abroad.

It is forecast that China's cheese market will continue to grow rapidly in the next five years, and that growth will spread from 1<sup>st</sup> tier city markets to 2<sup>nd</sup> and 3<sup>rd</sup> tier markets. Ongoing economic development will increase Chinese consumers' purchasing power, and make high-priced cheese products more acceptable for mass consumers.

### Yoghurt

The yoghurt market maintained its consistently strong growth in China in 2010. Yoghurt value sales increased by 14 percent in 2010, to exceed RMB33 billion. Even though the unit prices went up for both drinking and spoon-able yoghurts in 2010, pro/pre biotic spoon-able yoghurt is expected to record the strongest value growth. The increase of 38 percent was due to growing interest from leading players.

Thanks to long-term consumer education programs, Yoghurt is widely perceived as a health product that is good for digestion and weight control. This appeals to Chinese white collar consumers. Flavor innovation with new ingredients such as jujube, herbs, and cereals contributed greatly to sales growth.

Most health innovation is likely to focus on adding healthy ingredients such collagen for skin benefits, fibre for digestion, and lower fat content for slimming purposes.

**Figure 10: \*Sales of Yoghurt Values Break Down by Categories**

| RMB million       | 2005     | 2006     | 2007     | 2008     | 2009     | 2010     |
|-------------------|----------|----------|----------|----------|----------|----------|
| Drinking Yoghurt  | 1,227.38 | 1,519.70 | 1,871.54 | 2,015.81 | 2,230.99 | 2,469.27 |
| Spoonable Yoghurt | 602.48   | 695.48   | 778.10   | 834.85   | 988.02   | 1,111.73 |

Hangzhou Wahaha Group has overtaken Bright Dairy & Food Co.Ltd to be the number one player in yoghurt, accounting for almost 14 percent of value sales in 2009. Hangzhou Wahaha Group, Bright Dairy and Mengniu, were the domestic leaders in this sector in 2010.

Imported yoghurt enjoys a stable but small growth rate among expatriates or returned overseas Chinese. Emmi from Switzerland, Elle & Vive from France, Yoplait from Australia and FAGE from Greece are frequently available brands on the shelves of import food supermarkets/stores.

### Milk powder

Milk powder production increased to \$1,864.2 million in 2010.

In 2009, China found it difficult to export milk powder to overseas markets. Meanwhile, due to low prices in international markets, a large quantity of low-priced milk powder was imported into China. Milk powder imports during Jan-Oct, 2011 amounted to 379,000 metric tons, representing an increase of 14.5 percent by volume compared with same period in 2010. The import value reached US\$ 1.39 billion, an increase of 25.5 percent by 2010. Eighty two percent of the milk powder imported during the first ten months of 2011 was from New Zealand.

Infant formula powder sales grew steadily. High value-added infant formula milk powder markets in

China are nearly monopolized by multinational giants from Europe, the United States, and Australia.

Apart from the advantages in technology, foreign companies also enjoy a competitive edge in branding and channel management. In addition, foreign brand infant formula also enjoys higher degree of trust among Chinese consumers in a product category where trust issues are critical for consumers. Foreign infant formula brands increased their prices several times during the past year, but concerns about food safety have made young parents in China less price sensitive.

The top 5 international brands - International Nutrition (Dumex), Mead Johnson (Enfagrow, Enfapro, Enfachild, Enfaschool), Abbott Nutrition International (Gain, Similac), Nestle (Lactogen, Neslac), and Wyeth (Promise, S-26, Bright Promil) - took over 50 percent of the market. Beingmate overtook Yili (Inner Mongolia), Shengyuan (Shandong), Yashili from (Guangdong), and Wonder Sun (Heilongjiang) to become the star performer among domestic brands.

### 1.3 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.  | Fragmented markets in a geographically large nation with underdeveloped logistics and infrastructure as well as cold chain system.  |
| Upscale food makers eagerly look for high quality ingredients that add value to their products, and leading food makers are more likely to use imported ingredients to develop new products. | Food processing, retail and HRI sector as well as distribution channels in less developed areas lag far behind those in the affluent coastal region, hampering further penetration. |
| Increasing concerns about food safety and health creates more opportunities for high quality ingredients   | Incomplete Chinese standards and discrepancy between Chinese standards and U.S. ones may create technical barriers to trade.  |
| A large number of emerging city markets offer tremendous opportunities for growth.   | Increasing commodity prices and logistics costs offset depreciation of the U.S. dollar.   |
| The appreciation of the Chinese RMB will make U.S. products more competitive in this price sensitive market.   | Increased access for imports has resulted in greater competition from other exporting countries. TBT and SPS issues impact trade.   |
| China is a good base for value-added processing.   | Logistics and distribution channels in many emerging city markets still lag, and are a particular barrier for dairy products and fresh fruit.                                       |
| Various age groups, such as infants and the elderly, are driving demand for safer and healthier foods.   | Basic agricultural production is not well integrated with the commercial food processing sector.  |
| Effectiveness of the Food Safety Law and establishment of the State Food Safety Commission will create a friendlier environment for the food processing industry.                            | Chinese consumers are price-sensitive: imported products have difficulty competing with domestic substitutes on price alone.  |
| Urbanization and lifestyle changes favor consumption of more processed food.   | Infringement of intellectual property rights remains a serious concern in China.  |

|   |   |
|---|---|
| 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.                         | High rising costs is to impede the rapid growth of the industry.  |
|   | After two decades of fast development, the industry is likely to slow down.   |

## 1.4 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.

### 1.4.1 North East China

Northeast China, collectively referred to as 'Dongbei' consists of the three provinces of Liaoning, Jilin and Heilongjiang. The heartland of the region is Northeast China Plain. This region has a total population of 107,400,000 people, accounting for 8 percent of China's total population.

As the first part of China to develop heavy industry owing to its abundant coal reserves, Northeast China, on the whole, is more urbanized than most other areas. The main cities, Shenyang, Changchun, Harbin and Dalian, all have populations of several million inhabitants. Northeast China is an important agricultural region as well, producing the bulk of China's corn and soybeans, as well as other commercial food grains and economic crops for export throughout China.

### Liaoning

Liaoning has the largest economy of Northeast China. Its nominal GDP for 2010 was 1.83 trillion Yuan (ca. US\$270 billion), making it the 7th largest in China. Its per capita GDP was 41,782 Yuan (US\$6,172). Among the three provinces of Northeast China, Liaoning is the largest in terms of GDP. The main agricultural products include corn, sorghum and soybeans. The region around the port of Dalian produces three-quarters of China's exported apples and peaches.

Beer - People in northeast China have a long tradition of drinking beer, especially in the summer. There are 17 beer breweries in Liaoning, 10 of them owned by China Resources (Snow Flake). China resources accounts for 60 percent of the total beer production of Liaoning, followed by Harbin, Tsingtao, Yanjing and some minor local brands.

Seafood - Seafood processing is one of Liaoning's food processing industries and is mostly concentrated along the coastal cities of the Bohai Sea, especially in Dalian. Some processing plants buy aquaculture products from US and/or Russia and re-export them to the U.S., EU and Japan after processing. Liaoning Province Dalian Ocean Fishery Group Corporation is one of the largest seafood processors in China.

Dairy - Liaoning Huishan Group is the fourth largest dairy producer in China. In addition, Yili, based in Inner Mongolia, recently established a liquid milk and yogurt production base in Shenyang, Liaoning.

### **Jilin**

In 2010, the nominal GDP of Jilin province totaled 857.71 billion Yuan (US\$134.02 billion), with per capita nominal GDP of 31,306 Yuan (US\$4,891) in 2010.

Jilin's agricultural production is centered on rice, maize, and sorghum. Rice is mostly cultivated in the eastern parts; Changbai Mountains are an important source of lumber. Herding of sheep is an important activity in the western parts.

Jilin Province is one of the major commercial grains producing areas of China and it has been enjoying the highest per capita grain possession rate over China for many years consecutively.

### **Meat processing**

Jilin Haoyue Halal Meat Co. Ltd is the largest beef producer all over China, even in Asia. Its beef exports account for 50 percent of the total China's beef exports.

### **Heilongjiang**

In 2010, Heilongjiang's nominal GDP was 1023.5 billion Yuan (US\$150.51 billion); its per capita GDP was 26,006 Yuan (US\$3,824)

The agriculture of Heilongjiang, heavily defined by its cold climate, is based upon crops such as soybeans, maize, and wheat. Commercial crops grown include beets, flax, and sunflowers.

Beer - Harbin beer (belongs to Anheuser-Busch InBev), the earliest beer brewery set up in China (the year of 1900), is another strong brand over northeast, even China. It has a market share of 66 percent in Harbin and about 5 percent over China.

Dairy - Heilongjiang has the greatest number of milk cows and the highest production of milk among all the province-level divisions of China.

Wondersun Dairy Co. Ltd, a subsidiary of Beidahuang Agriculture Co. Ltd, is one of the largest dairy producers in northeast China, and Beidahuang Agriculture Co. Ltd is at present the largest agricultural product company all over China.

**Figure 11: Major Provinces' Food Processing Industry in Northeastern China by Province 2010**

| <b>Provinces</b>    | <b>Categories</b>      | <b>Number of Enterprises</b> | <b>Annual Sales (1 billion RMB)</b> |
|---------------------|------------------------|------------------------------|-------------------------------------|
| <b>Liaoning</b>     | Food Processors        | 1822                         | 202.94                              |
|                     | Food Manufacturers     | 454                          | 36.73                               |
|                     | Beverage Manufacturers | 282                          | 26.55                               |
| <b>Jilin</b>        | Food Processors        | 851                          | 116.27                              |
|                     | Food Manufacturers     | 186                          | 155.41                              |
|                     | Beverage Manufacturers | 232                          | 261.06                              |
| <b>Heilongjiang</b> | Food Processors        | 267                          | 84.29                               |

|  |                           |    |        |
|--|---------------------------|----|--------|
|  | Food Manufacturers        | 41 | 115.45 |
|  | Beverage<br>Manufacturers | 32 | 78.03  |

*Sources: Statistical Yearbook 2010 of the reported provinces*

### **1.4.2 North China**

North China is home to 15 provinces, special municipalities and autonomous regions, with a combined GDP of roughly \$1.98 trillion (slightly less than Brazil). The region covers nearly half of the land area of China, stretching from the Pacific coast of Shandong province, to the border of Afghanistan in Xinjiang. The provinces within the region vary so much geographically, socially, economically and culturally, it is hard to talk about them as a whole.

North China's food processing industry is clustered in the east part of the region on the North China Plain: Shandong, Hebei, Henan, Beijing and Tianjin. This region dominates China's meat processing, seafood processing, and beer industries, and is a major player in instant noodles and dairy products. The food processing industry benefits from its location in China's breadbasket, with Henan province dominating wheat and pork production, while Shandong is a major force in fruit and garlic production as well as fisheries. ATO/Beijing is in the final stages of identifying and cataloging the major players in various segments of North China's food manufacturing industry.

#### **Meat processing**

Meat processing is a major industry of the region. Henan is the largest meat processing province in China. It is estimated that 5 out of 10 of packages of ham sausages produced in China are made in Henan Province alone. Henan Shineway Group (Shuanghui), the largest meat processor in China, has also been the champion of China's top 100 food processors since 2005. Jinluo, located in Shandong province, is also a major player in meat processing in China.

#### **Frozen food**

Henan is also the largest province for frozen food manufacturing, and is home to a number of well-known brands such as Synear and Sanquan. These two companies each manufacture about 300,000 tons of frozen tangyuan, dumplings and hundun (wonton) and similar products, valued at roughly RMB5 billion. It is estimated the total frozen food market is as big as \$10 billion a year in China. Topin Group, also headquartered in Henan, is a leader in frozen vegetables and other lightly processed frozen foods, and is increasingly finding a role as a cold logistics and warehousing services provider for other companies.

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

Henan and Hebei are two of the major instant noodle manufacturing provinces in China. Master Kong in Tianjin, Baixiang in Henan, and Jinmailang of Hebei are among China's top producers of instant noodles and noodle foods in China. Competition in this market segment is fierce, and while producers are under pressure to keep costs low, they are actively seeking ways to innovate and introduce new products and flavors.

## **Seafood**

Seafood processing is one of North China's major food processing industries and is mostly concentrated along the coastal cities of the Bohai and Yellow Seas, especially in Shandong and Liaoning provinces. The majority of imported seafood products is processed in these areas then re-exported to the U.S., Japan and EU etc, however an increasing proportion of the processed product is remaining in China. Fishballs for use in hotpot and heavily processed squid products are among the products in high demand.

## **Beer**

Beer production is among the most significant processing industries in the region. Tsingdao and Yanjing, the 2<sup>nd</sup> and 3<sup>rd</sup> largest beer brands in China, are both located in the region. Shandong province, the home province of Tsingdao beer, produced the largest volume of beer in 2008. Yanjing Beer occupied a dominant 50 percent market share in North China, and more than 90 percent of the Beijing market.

## **Snack food**

Among the three snack food manufacturing centers, two are located in the region. One is Rongcheng in Shandong province, a manufacturing center of seafood snack foods; and the other is Luohe in Henan province, which hosts the largest number of major snack food brands in China.

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

**Figure 12: Major Provinces' Food Processing Industry in North China by Province 2010\***

| <b>Provinces</b> | <b>Categories</b>      | <b>Number of Enterprises</b> | <b>Annual Sales (1 billion RMB)</b> |
|------------------|------------------------|------------------------------|-------------------------------------|
| <b>Beijing</b>   | Food Processors        | 213                          | 27.7                                |
|                  | Food Manufacturers     | 226                          | 18.9                                |
|                  | Beverage Manufacturers | 65                           | 16.1                                |
| <b>Tianjin**</b> | Food Processors        | 163**                        | 32.9                                |
|                  | Food Manufacturers     | 138**                        | 23.3                                |
|                  | Beverage Manufacturers | 50**                         | 9.8                                 |
| <b>Henan</b>     | Food Processors        | 2040                         | 302.48                              |
|                  | Food Manufacturers     | 676                          | 113.2                               |
|                  | Beverage Manufacturers | 448                          | 67.3                                |

|                 |                        |      |       |
|-----------------|------------------------|------|-------|
| <b>Shandong</b> | Food Processors        | 4445 | 738.0 |
|                 | Food Manufacturers     | 1341 | 185.5 |
|                 | Beverage Manufacturers | 561  | 92.6  |
| <b>Shaanxi</b>  | Food Processors        | 160  | 18.5  |
|                 | Food Manufacturers     | 101  | 7.7   |
|                 | Beverage Manufacturers | 66   | 8.7   |
| <b>Hebei</b>    | Food Processors        | 754  | 137.0 |
|                 | Food Manufacturers     | 293  | 43.0  |
|                 | Beverage Manufacturers | 182  |       |

*Sources: Statistical Yearbook 2011 of the reported provinces*

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

*\*\*Numbers of enterprises are from the Yearbook 2010.*

### **1.4.3 East China**

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

With a population totaling 120 million and an advantageous geographical position, the Yangtze River Delta boasts one of the most vibrant regional economies in China. It's geographic scope includes Shanghai, Zhejiang and Jiangsu provinces, all ranked among the top 10 regions in terms of economic strength. While it occupies only 2.1 percent of China's land area, the region's GDP of \$1,530 billion accounted for more than 21.3 percent of China's GDP in 2010. The 16 cities in the region absorbed over 35 percent of foreign direct investment (FDI) in China over the past ten years. Food processors in Shanghai, Nanjing (Jiangsu Province), Kunshan (Jiangsu Province), Suzhou (Jiangsu Province) and Hangzhou (Zhejiang Province) have built a strong reputation in eastern China. They have created many famous brands of packaged food and beverage products.

#### **Food processors in East China**

"Made in Shanghai" has become a quality guarantee for Chinese consumers when they choose processed food products and beverages. Bright Food Group is the biggest food processor and distributor in Shanghai. Its sales revenue reached \$ 7.5 billion in 2009. Its sales and net income grew by 22 percent and 45 percent in 2010, respectively. It owns 8 nationally famous brands and over 30 regional brands focused on Shanghai. These include Bright Dairy for dairy products, Big White Rabbit for candy, Zheng Guang He for drinks and beverages, Ai Sen for processed meat products, Meilin for canned food products, Guan Sheng Yuan for honey products, and Gold Maple and Shi Ku Men for rice wines.

Bright Food Group already represents many famous food & wine foreign brands in China and is

aggressively acquiring enterprises in other countries. It has also expressed a strong interest in acquiring wine and dairy business in other markets. In January 2010, Bright Dairy bid \$1.4 billion in cash for Australia-based CSR's sugar unit. As of July, 2011, Bright Food group was considering a bid for a foreign wine company, Treasury Wine Estates, Ltd. (based in Melbourne). During 2005-2010, wine consumption in China increased by 75 percent and 2010 consumption was 3.5 billion liters. Analysts predict that by 2013, China may become the world's seventh largest wine market. In July 2010, Bright Dairy & Food and Bright Food unit secured a 51 percent stake in Synlait Milk, a New-Zealand based dairy enterprise. The infant formula brand Pure Canterbury, which will be manufactured and packaged 100 percent by Synlait in New Zealand, will be positioned as high-end infant formula products and be launched in eastern China market in early 2012.

Headquartered in Hangzhou, the largest city in Zhejiang, Zhong Cui Foods is a strategic global partner of Coca-Cola. It is also the first Coca-Cola bottler in China and focuses on soft drinks. Its sales reached \$ 472 million in 2010. The largest domestic beverage brand, "Wahaha", was also created in Hangzhou. Wahaha's 2010 sales revenue was as high as \$8.42 billion, and it has been honored as China's No.1 enterprise in the beverage industry for thirteen consecutive years. Ningbo, also located in Zhejiang, benefits from its coastal location and produces several kinds of processed seafood that are widely distributed throughout China. Lin'an is known as the Capital of Tree Nuts, and has a very competitive processing and distribution capacity for both local nuts and imported nuts such as American pecan.

Jiangsu Province is very strong in meat products and snack foods processing. Yu Run Group, China's biggest processed meat product manufacturer, is headquartered in Nanjing, the capital city of Jiangsu. A private company that started with meat processing in 1993, Yurun has grown into one of China's Top 500 enterprises, with 2010 sales hitting RMB 64.7 billion (\$10.2 billion). In recent years, Yurun Group has increased investment in logistics and supply chain integration, and has set up several agricultural product trading centers in various parts of China.

Suzhou is the economic capital of Jiangsu Province. It had the 6<sup>th</sup> highest GDP in China in 2010, after the 1<sup>st</sup> tier city group Shanghai, Beijing, Guangzhou, Shenzhen and Tianjin. It ranks No.2 in China in foreign investment attracted, just after Shanghai. Suzhou has attracted large investments by foreign food manufacturers including Nabisco and Rich Products from U.S., Pokka Four Seas from Japan, Loyal Food Industrial from Canada, President Instant Noodles from Taiwan, and Po Li Foods from Panama.

In 2010, Anhui Province including the four cities of Hefei, Ma'anshan, Wuhu and Tongling were added to the Yangtze River Delta in the expansion plan of the YRD Economic region. Although not traditionally strong in economic development, Anhui Province, which is located west to Jiangsu Province and Shanghai, is well-positioned to capture the industrial shift from China's coastal areas into the interior. Yili Dairy Group, Huatai Group and Unilever are the most well-known food processing enterprises. Modern Farming Group, which is headquartered in Ma'anshan, is quickly emerging as a new dairy giant in China.

The number of food and beverage manufacturers increased substantially from 2008 to 2009, which reflects the growing demand for processed foods as Chinese incomes continue to rise. The rapid expansion of the food and beverage industries indicate strong economic growth within the region.

**Figure 13: Food Processing Industry in YRDEZ by City and Province 2009:**

| Cities and Provinces | Number of Food Processors | Gross output value (1 million RMB) | Number of Food Manufacturers | Gross output value (1 million RMB) | Number of Beverage Manufacturers | Gross output value (1 million RMB) |
|----------------------|---------------------------|------------------------------------|------------------------------|------------------------------------|----------------------------------|------------------------------------|
| Shanghai             | 208                       | 24,309                             | 308                          | 36,932                             | 71                               | 16,287                             |
| Jiangsu              | 1754                      | 185,167                            | 443                          | 33,166                             | 246                              | 49,339                             |
| Zhejiang             | 1070                      | 65,384                             | 449                          | 34,568                             | 336                              | 40,290                             |
| <b>Total</b>         | <b>3,032</b>              | <b>274,860</b>                     | <b>1,200</b>                 | <b>104,666</b>                     | <b>653</b>                       | <b>105,916</b>                     |

Source: Shanghai, Zhejiang and Jiangsu Statistical Year Book

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. (For Zhejiang, “Food processor = “non-staple food processing; “Food manufacturers =”food manufacturing).

### **Food processing industry trends in East China**

Affluent consumers in the Yangtze River Delta are willing to pay premium prices for branded products with more variety and higher quality, and they are receptive to new flavors from overseas. A growing percentage of their spending is for imported products and products with imported ingredients - such as dairy products, snack foods, tree nut products and confectionary items. These consumers are very health-conscious and their demand for low-fat, low-salt, low-sugar and even organic and natural foods & beverages drive innovation and product development in Yangtze River Delta.

Higher incomes are allowing consumers in East China to become more concerned with their quality of life and the quickening pace of life. The acceptance of ready-to-eat and prepared foods - including bakery foods and processed frozen foods is increasing. Meanwhile, the continuing process of urbanization and the increasing influence of Western cuisine culture is driving demand for convenient, healthy, and fortified food products.

Large scale food processors in East China are attaching more and more importance to new technologies and new process, so as to secure consistent product quality and standardization of the manufacturing process. Thanks to the new processing technologies adopted, many food ingredients manufacturers in East China are able to extract high quality ingredients, such as amino acids, stevia, and tocopherol for manufacturers of nutrition products and dietary supplements.

Meanwhile, food and beverage packaging is also experiencing constant innovation. Packaging has evolved from its traditional role of protecting and preserving the food products into an important marketing tool to attract the attention of and enhance communication with the consumers. Green

packaging and environmental friendly disposal of the used packaging materials are frequently mentioned to promote the responsible corporate image of the food processors. Bright Dairy initiated a milk cartons recycling event during Feb – April 2010, and a total of 113 tons of milk cartons were collected by some 728,000 Shanghai citizens. These used cartons were then made into 2,000 benches and installed at the 2010 Shanghai World Expo Park.

#### 1.4.4 Southwest China

Southwest China, which covers Sichuan, Yunnan, and Guizhou Provinces, the Chongqing Municipality and Tibet Autonomous region, has a population of 208 million (larger than the population of Brazil) and a regional GDP of more than \$340 billion (greater than the GDP of Taiwan). Sichuan Province is the powerhouse in the region, and shares borders with Chongqing in the east, Yunnan and Guizhou in the south and Tibet Autonomous region in the west. Chengdu, Chongqing, Kunming, and Guiyang are the major leading economic development cities in this region. Reflecting China’s commitment to “Go West!” and promote market development in China’s interiors, growth for the regions’ largest cities has been among the highest in the nation. With 19 million hectares cultivated land, about 15.7 percent of total national arable land, southwest China region produced \$109.4 billion value of agricultural products in 2009, accounting for 23.3 percent of region’s total GDP. This volume provides abundant resources for the food processing industry in southwest China. There are more than 3,100 food processing companies in the southwest China region. About 57 percent are food processors, 19 percent are food manufacturers and 24 percent are beverage manufacturers. Sichuan province leads the food processing industry in the region, accounting for about 64 percent of the food processors and manufacturers in this region and 46 percent of the region’s total GDP.

**Figure 14: Food Processing Industry in Southwest China by City and Province 2009\***

| Provinces & Cities |                        | Number of Enterprises | Gross Output (Million US \$) |
|--------------------|------------------------|-----------------------|------------------------------|
| Sichuan            | Food Processors        | 1088                  | 23,124.9                     |
|                    | Food Manufacturers     | 414                   | 4,864.1                      |
|                    | Beverage Manufacturers | 497                   | 17,261.2                     |
| Chongqing          | Food Processors        | 388                   | 3,657.1                      |
|                    | Food Manufacturers     | 151                   | 1,112.8                      |
|                    | Beverage Manufacturers | 84                    | 1,295.6                      |
| Yunnan             | Food Processors        | 288                   | 3,145.4                      |
|                    | Food Manufacturers     | 87                    | 680.3                        |
|                    | Beverage Manufacturers | 150                   | 1,193.6                      |
| Guizhou            | Food Processors        | 150                   | 1,040.6                      |
|                    | Food Manufacturers     | 49                    | 604.3                        |
|                    | Beverage Manufacturers | 101                   | 2,692.3                      |
| Regional Total     |                        | 3447                  | 60,672.2                     |

*Data source: Sichuan, Chongqing, Yunnan, Guizhou Statistical Year Books 2010\* Latest available data, including only those enterprises that realized annual sales over US \$735,294 (RMB 5 million) in FY 2008*

*\* US \$ 1 = RMB 6.65*

## **Food processing industry in Southwest China**

As exports are not the dominant revenue source for the food processing industry in southwest China, the industry was not affected by the global economic downturn that began in 2008, but is still developing rapidly. The leading manufacturers have gained more market share by merging the small scale processors and expanding dramatically, thus the number of large scale manufactures continues to increase. Due to intense competition, many small scale factories or plants were squeezed out of the market or merged with larger players in the industry. The top one hundred manufacturers are making more than half of the total sales value and revenue of that of the whole industry. In order to be more competitive, all manufacturers must adopt new technologies, develop new products, and improve safety standards to meet higher export requirements.

More and more leading national and multinational manufacturers also began to enter the emerging southwest China market and are expected to gain a higher market share. With less competition, leading manufacturers will find it easier to gain market share in the region. President Enterprises (China) Investments built their \$20 million processing factory in Chengdu, Sichuan in 1993, and now Chengdu Uni-President Enterprises Food Co. Ltd. is the largest food processing company in Sichuan in terms of sales volume. Ting Hsin International Group also performs strongly in southwest China due to strong marketing strategies, and they have been present in bakery products, dairy products, noodles and baby food. Coca-Cola set up Chengdu Coca-Cola Beverage Co., Ltd. in 1996, and has ever since played a big role in the local beverage market. In 2008, Pepsi set up the largest soft drink production factory in West China in Chongqing. Pepsi plans to open a new beverage manufacturing plant in Kunming in the next year. Leading sauces manufacturer Lee Kum Kee is also planning to strengthen its presence in southwest China, as it is already performing well in East and South China regions. Foreign investment in food processing industry is likely to increase in southwest China. Low production costs including low rental costs, labor costs and raw material costs in the region will remain attractive to multinational manufacturers.

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

## **Sichuan**

The major food processing sectors in Sichuan include liquor, beverage, meat processing, animal feed, edible oil, and cereal, and major manufacturing products are liquor, soft drinks, rice and flour products, snack foods, frozen products, refined tea, dairy products, canned/preserved products, and seasoning products. The processors and manufacturers are mostly located in the fast growing emerging cities like Chengdu, Yibin, Luzhou, Ziyang, Nanchong, Neijiang, Deyang, Zigong, and Suining. These areas contribute over 79 percent to the province's food processing industry. Sichuan is famous for alcohol production and has a long history of liquor consumption. Annual production in 2009 reached 1.56 million tons, an increase of 40.7 percent compared to 2008. Sichuan province is the number one liquor

production area in China. Lu Zhou Lao Jiao, Jian Nan Chun, Wu Liang Ye, Lang Jiu and Tuo Pai liquor manufacturers in Sichuan are the leading liquor manufacturers nation-wide. The liquor production sales value reached USD \$11.9 billion in 2009, which represents an increase of 34.22 percent compared with the previous year. Dairy product production totaled 0.47 million tons with a USD \$0.74 billion net profit in 2009. Beer production reached 1.6 million tons with USD \$7.03 billion in sales, an increase of 64.5 percent compared with 2008. Soft drinks production hit 3.5 million tons in 2009.

## **Yunnan**

Yunnan province is well-known for its sugar, tea, and wine production in the food processing industry. In 2009, gross value of farming, forestry, animal husbandry and fishery reached USD \$2.57 billion, with farming representing USD \$1.28 billion. Total grain production reached 15.8 million tons, accounting for three percent of national grain production. Sugar production reached 2.23 million tons, accounting for 16.9 percent of national total. Production of pork, beef and mutton combined totaled 2.7 million tons and accounted for 4.6 percent of the national total. Refined tea reached 98,328 tons and wine 6,529 kiloliters. The sales value for sugar products reached USD \$807 million (2007).

There are more than 5,680 tea processing factories in Yunnan, processing over 450,000 tons of tea annually, including red tea, green tea, Wulong tea, PuEr tea, jasmine flower tea, and instant tea. Yunnan is famous for its extraordinary PuEr tea which was identified as a very healthy tea by Chinese scientists. During a three-day Tea Trade Fair in 2007, USD \$183.4 million worth of purchasing contracts were signed on-site for PuEr tea, and about 28 joint projects for PuEr tea were signed bringing another USD \$156 million worth of contracts. Yunnan's wine production is proudly ranked number ten in China, with annual output of 8,170 kiloliters (2007), worth USD \$17.4 million. The main vineyards in southwest China are located in the Yunnan-Guizhou Plateau. Grape cultivation has a long history in Yunnan. Yunnan Gaoyuan Wine Co.,Ltd and Yunnan Shenquan Wine Co.,Ltd. are the two biggest wineries in southwest China. Yunnan Gaoyuan Winery now has 1334 hectares of premium vineyard growing a lot of grape varieties including Rose Honey, Merlot, Cabernet Sauvignon, Grenache, Yan73, Italian Riesling and Chardonnay. Their plantings of Merlot and Cabernet Sauvignon grapes represent the largest planted area for wine grapes in the Province. Their wine brands "Yunnan Hong" and "Shangri La" become famous brands in wine industry and rank number six in southwest China and has been more competitive due to their distinctive market and special flavor.

## **Chongqing**

The major food processing products in Chongqing are beer, pickled products, processed meat products, condiment/seasoning products, canned/preserved products and dairy products. Chongqing's beer production was 727,700 kiloliters in 2009, accounting for 1.7 percent of national total production and bumping Chongqing up to number six in ranking in terms of annual output. The Municipality's dairy production reached 113,200 tons in 2009, accounting for 0.6 percent of the national total production, which remarkably is the highest in southwest China. As pickled products such as vacuum-packaged pickled poultry products are very popular products in southwest China, U.S. poultry products such as turkey wings, wingtips, chicken paws, and chicken wingtips have gained great market share in the poultry products processing industry recent years. Chongqing's condiment products like packaged hotpot condiments are also sold well across China.

## **Guizhou**

The food processing industry in Guizhou is less developed compared with other major food processing areas in southwest China. The Province's production of liquor, beer, beverages, dairy products, and canned products were 137,900 kiloliters, 275,400 kiloliters, 540,500 tons, 40,705 tons, and 10,516 tons, respectively, in 2009.

### **Consumer trends & opportunities for U.S. food manufacturers & ingredients suppliers**

As for consumer trends, demand for convenience, health, low-fat and fortified processed products is expected to grow in southwest China in the next five years. Compared with the high percentage (80 percent) of processed food consumption in Western countries, the percentage of processed food consumption in China is only around 30 percent, and even lower in the southwest region. With sustained and rapid growth of per capita disposable income, consumers in urban areas of southwest China show more interest in value-added processed food items which are more convenient, healthier, of better quality and of more variety choices. This creates demand for U.S. processed foods and ingredients. The popular value-added food items are dairy products, baby foods, oils and fats, meats, poultry and seafood. Baked goods and processed cereals are increasingly accepted by local consumers as well. Thriving catering companies and the booming restaurant sector are also increasing demand for value-added processed products. Consumers in southwest China have also become increasingly focused on product quality, flavor, and nutrition in addition to price. This indicates potential for boosts of sales of U.S. high-quality rice, soybean, corn, dried fruits and nuts, and premium canned or packaged food products. Love of strong flavors in this region provides tremendous sales opportunities for U.S. high-grade sauces, dressings and condiments manufacturers. When targeting this area's customers, U.S. food manufacturers may consider adding local preferred flavors, and some popular herb extracts ingredients such as honeysuckle and chrysanthemum, which are treated as healthy ingredients in the local market. Organic product production is also promoted by the government and organic products are welcomed by consumers, believed to be "more safe" than products produced using traditional methods. As healthy-eating trends continue in popularity, the consumption of better quality U.S. food products would for sure increase by a large portion. Having good image of quality, health, and safety, U.S. food products and ingredients should find large potential market in this area.

#### **1.4.5 South China**

Thanks to a more developed market economy, South China's food processing companies are more modern and financially solvent and currently dominate the market in South China. The most developed provinces in South China are Guangdong, followed by Fujian, then Hunan, Guangxi, and Hainan. Processors in Guangdong and Fujian cover all lines of food products, drinks, and snacks. Guangxi and Hainan produce traditional food and drinks, and their product sales largely remain in their respective provinces, with the exception of coconut juice from Hainan which has conducted a major national media campaign. Some products from Hunan appear on shelves outside of the province, but in general, Hunan processed foods are not well-known in China.

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

**Figure 15: Food Processing Industry in South China by 2009\***

| Provinces        | Categories             | Number of Enterprises | Gross output value (billion US\$) |
|------------------|------------------------|-----------------------|-----------------------------------|
| <b>Guangdong</b> | Food Processors        | 959                   | 23.34                             |
|                  | Food Manufacturers     | 851                   | 13.78                             |
|                  | Beverage Manufacturers | 277                   | 9.29                              |
|                  | <b>Total</b>           | <b>2,087</b>          | <b>46.41</b>                      |
| <b>Fujian</b>    | Food Processors        | 8,482                 | 3.19                              |
|                  | Food Manufacturers     | 5,455                 | 1.68                              |
|                  | Beverage Manufacturers | 8,263                 | 1.55                              |
|                  | <b>Total</b>           | <b>22,200</b>         | <b>6.42</b>                       |
| <b>Guangxi</b>   | Food Processors        | 518                   | 13.59                             |
|                  | Food Manufacturers     | 157                   | 1.38                              |
|                  | Beverage Manufacturers | 150                   | 2.31                              |
|                  | <b>Total</b>           | <b>825</b>            | <b>17.28</b>                      |
| <b>Hunan</b>     | Food Processors        | 734                   | 6.47                              |
|                  | Food Manufacturers     | 288                   | 2.69                              |
|                  | Beverage Manufacturers | 213                   | 1.31                              |
|                  | <b>Total</b>           | <b>1,235</b>          | <b>10.47</b>                      |
| <b>Hainan</b>    | Food Processors        | 81                    | 1.259                             |
|                  | Food Manufacturers     | 27                    | 0.483                             |
|                  | Beverage Manufacturers | 15                    | 0.236                             |
|                  | <b>Total</b>           | <b>123</b>            | <b>1.98</b>                       |
|                  | <b>Regional Total</b>  | <b>26,470</b>         | <b>82.56</b>                      |

Sources: Statistical Year Books 2010 of reported provinces

### **Fujian province**

Known as the largest food processing manufacturing base in South China, but with a highly fragmented industry dominated by small family-owned operations, these products are mostly sold domestically.

Fujian supplies the country with a full selection of beverages, confectioneries, packaged baked products, potato chips, shrimp chips, cookies, crackers, frozen vegetables, canned food, and snacks. In order to gain market share, many sizable companies have developed a wide range of product lines. For example, the vertically integrated bakery retail giant, Sunmile, located in Xiamen, is the largest bakery chain in South China with over 145 bakeries across the country and planning to expand to 1,000 bakeries by 2015. Sunmile is also the third largest bakery chain in China, right after Christina bakery in Shanghai and Haolilai in Beijing. Besides producing mid-level fresh bakery items, this Taiwanese owned enterprise sells packaged baked items exclusively in their own retail chain outlets.

The largest food manufacturing enterprises include:

Live Stock & Poultry product-Quanzhou Food Co, Ltd,

Herbal Beverage- Fujian Huian Laoba Food Co, Ltd

Vegetable- Xiamen Tongan Minnan vegetable market; Putian Xinmei Co, Ltd;

Canned Food- Fujian Nanpu Industrial Co, Ltd; Jinjiang Yongxiang canned food Co, Ltd

Frozen Food - Fujian Changtai Taihua food Co, Ltd

### **Hainan province**

The largest food manufacturing enterprises include:

Fresh Fruit- Hainan Sanli Import & Export Co, Ltd; Qiongzong Lvkenong Fruit Co, Ltd

Flower plant- Hainan Haoran agricultural Co, Ltd

### **Hunan province**

Hunan province is the largest producer of oilseeds with 30 billion tons grains and 80 million hog in 2010. This large agricultural province neighbors likewise major supplying Guangdong of pork and poultry products.

The largest food manufacturing enterprises include:

Foodstuff – Hunan Kaixue Group

Vegetable – Changsha Mawangdui Co, Ltd

Vegetable & livestock – Hunan Yixin Chuanghui Industrial Co, Ltd

Animal Feed- Tianxin Industrial Co, Ltd; Changsha Huaying Industrial Co, Ltd

Tea product- Hunan Tea Product Company

Oil- Changsha Vegetable Oil Company

Seasoning- Huanan Lianbang Food Co, Ltd

### **Guangxi province**

Guangxi is best known for its sugar cane production; the country over 64 percent finished sugar products are made from Guangxi. Other than sugar, meat, vegetables and tobacco are its major agricultural products that supplies domestically. Most of Guangxi processed food is rough finish due to lack of standardize management and backward technology and equipments. Guangxi traditional rice noodle and chilly paste are the two main categories for processed food. Many small food processing plants contribute to the province's food sales, but their development lags behind other players in South China.

The largest food manufacturing enterprises include:

Instant Food- Guangxi Heiwulei Food Group

Fruit and Vegetable Canned Food – Guangxi Meitong Food Co, Ltd

Animal Feed- Guigang Yangxiang Animal Feed Co, Ltd

### **Guangdong province**

Guangdong has the highest GDP of all of China's provinces, and is the largest center of demand for processed foods. Sixty seven percent food supplies in Guangdong are purchased from other provinces or imported. The food processing industry is one of the largest industries in Guangzhou with 2,087 scaled food processing enterprises and 11,157 licensed food processing companies, whose total industrial output is valued at \$51 billion (2011 statistics from the Administration of Quality and Technology Supervision of Guangdong Province). The province is home to various national brands, helping to cement its reputation in terms of capitalization and technology, food safety, quality, advanced packaging technology, and services. Functional drinks, health foods and supplements are in greater demand because consumers in this market are increasingly health conscious and have higher disposable incomes than consumers in other provinces. Many educated consumers require food or drink containing less chemicals and additives. Both processors and consumers in the province have been exposed to imported ingredients for many years, creating excellent market potential.

The largest food manufacturing enterprises include:

Processed meats - Guangdong Shuanghui Wens Group; KwangFeng Co.;Ltd, Changjiang Foodstuff Goup.

Alcoholic Drinks – Guangzhou Zhujiang Brewery Group, [Shenzhen Kingway Beer](#), [Zhaoqing Bu](#)

Soft Drinks – Jianlibao, C-estbon, Robust

Baked goods - Liangxianglou, Taotaoju, Guangzhou Restaurant

Seafood – Guangzhou Haizhu Aoxin Seafood, Guangzhou Lingshan Aquatic

Seasonings- Jialong, Pearl River Bridge

## SECTION II MARKET ENTRY

### 2.1 Entry Strategy

Apart from the general business rules applicable anywhere, it's recommended that those who are interested in the China market bear in mind the following tips while getting started.

1. **China is immense and opportunities are ample.** China is a surprisingly diverse place in terms of culture, business practices and levels of economic development. Opportunities exist for most products here – the big question is how to structure them so that they can be profitable.
2. **China is not a unified market and thorough market research is critical before trading with China.** Again, China is extremely diverse – it is also highly fragmented. There are virtually no nationwide distribution systems, so it is extremely important to identify a specific market in China to target. Exporters are strongly advised to study the market and determine the region, demographic and market segment they want to target, as the marketing strategy will differ for any given market.
3. **It is critical to find good partners,** particularly among **importer/distributors.** Unless you have the resources to launch your own marketing operations in China, your importer/distributor will do most of the marketing, up to and including deciding how your product is presented in the Chinese markets. It is critical that they have both the capacity to market your product effectively, and that they be of a similar mind to you on how the product is to be distributed and

marketed. It is highly recommended that you meet with prospective distributors in person and visit their facilities.

4. Four, **exhibitions** can be a cost effective approach to understanding the market and meeting agents/importers. For food ingredients, the leading shows are the Bakery China Show and FIC (Food Ingredients China). Contact the ATO in the region you are interested in to learn more about other shows that may be in the works.
5. Five, be open to **different import channels**. Lean economic times in 2009 have driven some processors, manufactures and hypermarkets to consider direct sourcing of products from producers to reduce costs. However, in some cases it might not be possible to get into China by bypassing importers/distributors. Keep in mind that these distributors absorb much of the transaction risk, and perform a valuable service.
6. Six, **Chinese business culture matters**. The most distinctive highlight of the Chinese business cultures is the need to cultivate Guanxi, or relationships. The 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. This is another good reason to visit your importer/distributor partners, as it will help build trust with them. Better still, your importer may take advantage of your visit to take you to meet their key buyers, building their guanxi with the buyer and demonstrating your commitment to this market.

All of the ATO offices (Beijing, Shanghai, Guangzhou, Chengdu and Shenyang) 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 China representative offices of various industry groups, including USDA cooperators, are another important source for information and assistance.

## 2.2 Market Structure

### 2.2.1 Distribution Patterns

#### **Traders/importers**

The most traditional pattern is for the U.S. exporter to sell to a Chinese importer/distributor, who then markets on to the end user. These distributors provided full-service operations, not only covering Customs clearance and warehousing, but also more or less determining how the product was represented and sold in China, and providing customer service to the end user. The distributor also typically absorbs the market risk in any transaction, and for distribution into channels, like retail, where risk is very high (non-payment by retailers is fairly common in China), distributor markups are correspondingly high. Other distributors provide the full spectrum of service levels, from simple freight forwarding all the way up to full-service. It is worth noting that some of the original state-owned import operations, such as COFCO, are still among the largest importers, and provide import services for many of the small and

medium sized firms that are too small to work with highly specialized distributors.

### **Direct distribution**

As the markets in China continue to grow, more and more U.S. companies are establishing their own distribution in China (typically through partnerships, due to legal issues). These can be more expensive, but have the advantage of putting you in direct contact with your final buyers. This provides better control over how the product is marketed, and gives the exporter a better feel for the dynamics of the market.

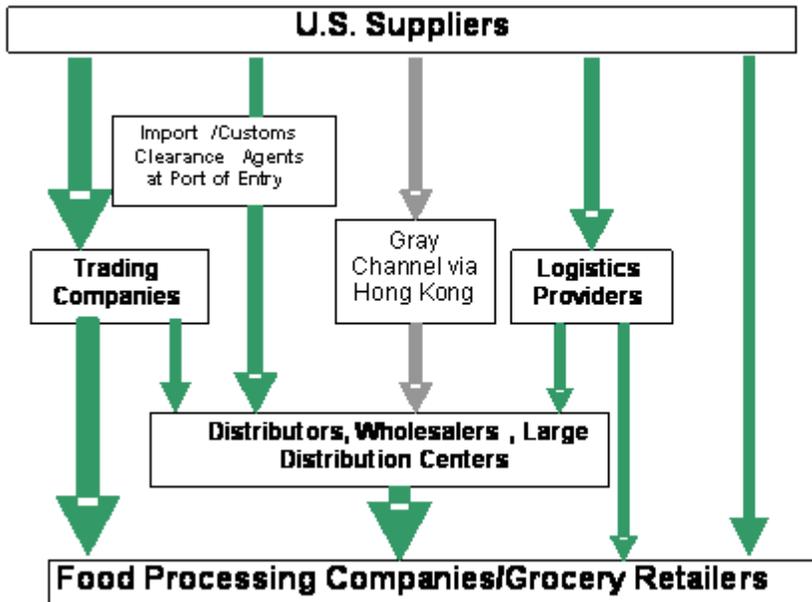
### **Direct selling to large sellers/processors/manufactures**

As import volumes increase, Chinese food manufacturers are increasingly seeking to cut costs by eliminating the importer/distributor step and purchasing directly from the U.S. This change has been relatively slow, however, as the cost to a manufacturer of setting up their own import and Customs clearance operations is significant. If volumes are sufficient and you can establish direct contact with the buyer, however, this represents a good potential opportunity. If you are a U.S.-based sales agent, however, keep in mind that the Chinese buyer may eventually seek to reduce costs further by going direct to the U.S. manufacturer.

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

The flow chart below is a summarization of the discussions made above.

### **Figure 16: Distribution Flow Chart**



Source: ATO

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

### 2.2.2 Distribution Channels (Gray Market)

Apart from normal trading channels, there is a gray market channel that operates in China, moving imported cargoes to the mainland via a third country/region such as Hong Kong. Originally, this channel developed as a means for Chinese importers to evade trade restrictions, but as trade has become more open, it persists as a way to a) evade duties and valued added tax (VAT), and b) simply because importers who rely on the gray market channel can avoid being involved in the paperwork and licensing involved in formal import transactions. This does not come for free, of course, and the amount saved by going through the gray market is usually relatively small when all factors are taken into consideration. The gray market channel is, generally, a negative influence, as it distances exporters from their buyers and end users: when a product enters the gray market it is impossible to know where it will end up, in what form, or how it will be used. Product adulteration is not uncommon in this channel, and exporters should be aware that this can affect the reputation of their products in China. Exporters are generally advised to avoid the gray market channel.

### 2.2.3 Distribution Flow

China is generally divided into three regions.

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

**East China,** which includes Shanghai, Jiangsu, Zhejiang, Anhui, Fujian, Jiangxi, Hubei, Hunan,

Chongqing, and Sichuan. Ports like Shanghai and Ningbo are the largest.

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

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

**Figure 17: Volume of Freight Handled in major Coastal Ports 2007-2010** (10, 000 metric tons)

| Seaport         | 2007  | 2008  | 2009  | 2010  |
|-----------------|-------|-------|-------|-------|
| Shanghai        | 49227 | 50808 | 49467 | 56320 |
| Ningbo-Zhoushan | 47336 | 52048 | 57684 | 63300 |
| Guangzhou       | 34325 | 34700 | 36395 | 41095 |
| Tianjin         | 30946 | 35593 | 38111 | 41325 |
| Qingdao         | 26502 | 30029 | 31546 | 35012 |
| Dalian          | 22286 | 24588 | 27203 | 31399 |
| Qinhuangdao     | 24893 | 25231 | 24942 | 26297 |

Source: China Statistical Yearbook, 2011

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

## **SECTION III BEST PRODUCTS PROSPECTS**

### **3.1 Prospects Categories**

Generally speaking, product prospects are determined by a number of factors, including product uniqueness, quality, comparative price advantage, demand growth and marketing efforts. For purposes of this report, prospects are categorized as follows:

**Figure 18: Product Prospects Categories**

| <b>Prospects</b>      |  |
|-----------------------|--|
| <b>In high demand</b> | Products that are in high demand in China with limited alternatives or a substantial price/quality advantage |
| <b>Good prospect</b>  | Ingredients that are showing a price or specific quality advantage in  |

|                                  |  |
|----------------------------------|--|
|                                  | comparison with alternatives   |
| <b>Long-term prospect</b>        | Products for which production is shrinking or flat, but demand is increasing                   |
| <b>Conditional good prospect</b> | Products that could do well, but will require marketing support or efforts to close price gaps |

### 3.2 Example Products Analysis

The following table provides examples of this approach:

**Figure 19: Example Products into the Prospects Categories Analysis**

| <b>Prospects degree</b> | <b>Example product</b>   | <b>Product uniqueness/ limited supply</b> | <b>Comparative price advantage</b> | <b>Demand growth in relevant subsector</b> | <b>Marketing efforts</b> |
|-------------------------|--------------------------|---|------------------------------------|--|--------------------------|
| In high demand          | <b>almonds, soybeans</b> | Yes                                       | Yes                                | Yes  | Yes                      |
| Good prospects          | <b>pork, walnuts</b>     | No  | Yes                                | Yes  | Yes                      |
| Long-term prospect      | <b>Dry beans</b>         | No  | Not yet, but likely                | Yes  | No                       |
| Conditional prospect    | <b>Black walnuts</b>     | Yes                                       | No                                 | Yes  | No                       |

#### Almond

Almonds are the best example for category one. It is a U.S. product with few competitors that has benefited from the rapid development of China's thriving bakery and snack food sectors, and benefits from an outstanding marketing effort by the Almond Board of California. That's why it's been growing its exports to China from 900 metric tons of 2006 to 12,972 metric tons in 2011, an increase of 14.4 times in five years.

#### Walnuts

China is the world's largest walnut producer, but thanks to a comparative price advantage, strong demand from the beverage and bakery sectors, and the continuous marketing efforts of the California Walnut Commission, exports of walnut from the U.S. to China have climbed to 18,195 metric tons of 2011 from 3,311 metric tons in 2006, an increase of 5.5 times over five years. The comparative price advantage and strong food sector demand are closely connected in this case: beverage and bakery sector demand pushed the price of domestic walnuts up to RMB42,000 - 45,000 per metric ton in the second half of 2011, in comparison with a price of only RMB38,500 a metric ton for U.S. product.

#### Dry beans

Similar to walnuts, dry beans are not a unique product of the U.S., and China is the largest producer in

the world. In this area, U.S. dry beans do not enjoy a price advantage. However, discussions with food manufacturers indicate that long-term prospects are good, provided efforts are made to market the product. Increasing interest in healthy foods and lifestyles, along with demand for greater convenience, are helping to build demand for dry beans in processed foods, while production is generally declining as farmers switch to more profitable crops. Traditionally used in “Zhou,” a rice porridge, and various bean pastes used in fillings, there is growing interest in innovative new uses. However, this will require experimentation and adaptation on the part of food processors, particularly where the U.S. product differs slightly from domestic alternatives. With narrow margins, processors will require technical assistance to develop these new products. The long term advantage of the U.S. product lies in the marketing systems that sort and grade beans into a very narrow specification: this appeals to Chinese manufacturers, who when purchasing domestic product are often left to handle these tasks themselves. Long-term efforts to work with domestic manufacturers to develop new products and uses for the Chinese market have the potential to build a substantial market for these products.

**Black walnuts**

Black walnuts are a good example of a product falling into category four. It is distinctive, and the sectors in which it is most likely to be marketed, dairy (ice cream) and bakery are growing quickly. However, awareness of its uniqueness is low, as a result of which the product tends to be compared to regular domestic walnuts, which are significantly cheaper. Whether or not this product is likely to find a market in China will depend largely on marketing efforts to alert manufacturers to the distinct flavor and quality of this product, and their success in passing this message along to consumers.

**3.3 Fastest Growing Market Segments**

Producers and exporters are more aware of product uniqueness, comparative price advantages, and marketing efforts of their own products. The only outstanding indicator could be the thriving degree of sub food sector. Below is a rating system on different sub sectors and products employed in the sectors.

**Figure 20: Market Segment Growth Rates and Ingredients Used**

| <b>Food sectors</b>          | <b>Growth Rates</b> | <b>Ingredients</b>  |
|------------------------------|---------------------|---|
| Prepared meats food          | Rapid               | Meats and by products, poultry and by products, surimi and seafood wastes, starch |
| Bakery                       | Rapid               | Nuts, fruits, beans, wheat flour  |
| Frozen food                  | Rapid               | Nuts, fruits, meats, starch   |
| Dairy and ice cream          | Above Average       | Nuts, fruits, beans   |
| Confectionery and chocolate  | Above Average       | Nuts, fruits, beans   |
| Beverage                     | Above Average       | Nuts, fruits  |
| Noodle food, instant and dry | Average             | Wheat flour, beans  |

## **SECTION V POST CONTACT AND FURTHER INFORMATION**

For further information about the China market, please visit our website at [www.usdachina.org](http://www.usdachina.org) or contact any of the following USDA offices in China:

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