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China, Peoples Republic of

Retail Food Sector

Report

2002

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Report Highlights:
China's food retail sector continues to grow and change as more hypermarkets and convenience stores open across the country. Hypermarkets are now present in all major and most second-tier cities.

Includes PSD changes: No
Includes Trade Matrix: No
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I. Market Summary

I.A Overview of the Retail Food Market in China

China's food retail sector has undergone a rapid transformation that has seen the introduction of modern food retail models such as supermarkets, hypermarkets and convenience stores. Much of this growth has come at the expense of traditional outlets such as wet markets, foodstuff stores and small 'mom and pop' variety stores (known as xiaomaibus). Supermarkets are now common nationwide. The change is most noticeable in the leading three cities, Shanghai, Guangzhou and Beijing, although hypermarkets and convenience store chains have also made considerable inroads into wealthy second-tier cities such as Qingdao, Dalian and Shenzhen, in the coastal areas of China. Long-term growth is likely to slow in Shanghai, where hypermarkets are approaching saturation levels and explosive growth in convenience stores have caused per-store revenues to fall. Continued rapid growth in second-tier cities is likely to offset this and contribute to overall national growth in hypermarkets and convenience store chains.

According to China's Chain Store Association, as of 2001 there were 91 retail chain store companies in China with total sales revenues of RMB 116 billion. The total number of stores was 7,953, of which 3,328 were supermarkets, 271 hypermarkets, 3,342 convenience stores and 60 warehouse stores. Although average per-store gross profits were constant in 2001, per-store net profits fell slightly, showing the effects of greater competition. Over half of China's convenience stores were located in Shanghai.

Supermarket chains are dominated by state-owned domestic chains, most notably Lianhua (now China's largest retail company), and Hualian and are the most common food retail format in China. The exception to this rule is Lotus, which is owned by Thailand's C.P. Group, and specialty stores in large cities that serve the local expatriate market. Competition is ferocious and margins are thin. Dutch retailing giant Royal Ahold withdrew entirely from China, and Hong Kong's Park 'N Shop has withdrawn from northern and eastern China to focus on the south. The appearance of hypermarkets is bringing in more competition, although supermarkets remain dominant in medium and small cities and for daily shopping. Supermarket chains are generally less sophisticated in their purchasing, distribution and management systems and layouts than either hypermarkets or convenience store chains. Penetration of imported foods is quite low, even in large cities. Supermarkets normally feature extensive frozen and refrigerated sections with a wide variety of products ranging from frozen dumplings to dairy products. The quality and variety of fresh meat and vegetables however, is variable and many customers still make daily purchases of these products from streetside vendors or at wet markets.

Hypermarkets were pioneered by foreign invested companies such as Carrefour (France), Metro (Germany) and Makro (Netherlands), and these companies remain the strongest competitors in the market. More recently, U.S. retailing giant Wal-Mart has entered the market, starting in southern China and moving quickly on to second-tier cities such as Dalian and Harbin in northeast China, with ambitious plans for expansion into more competitive markets such as Shanghai. Foreign-operated hypermarkets are comparable to their overseas counterparts in terms of management and layout, with some adjustments for the Chinese market. In response, a number of Chinese chains, most notably Lianhua and Nonggongshang, have begun to establish hypermarket chains of their own, and local companies in many of China's smaller cities have set up small, free-standing hypermarkets or small (i.e. two store) hypermarket chains. In addition to the standard mix of products, hypermarkets are featuring a growing range of ready-to-eat products, and kiosks selling freshly-cooked snacks are a common feature. A small but important addendum to this category are Chinese department stores, which routinely include a food section occupying one or more floors. Management changes at some of these stores have turned them into mini-hypermarkets, sized somewhere between supermarkets and hypermarkets.

Convenience store chains are dominated by Chinese companies (including, of course, Lianhua) with a significant number of joint ventures, such as that between Japan's Lawson and Hualian. Nearly all of these chains are affiliated with a larger company of some sort. Shanghai, with over half of China's convenience stores, is oversaturated, and most industry observers expect a series of mergers and consolidations within the next year. Despite this, several foreign chains, including 7-11, plan to open more stores in Shanghai. Speculation on possible buyouts by foreign chains has further fueled overexpansion in the Shanghai area. Meanwhile, the well-established chains such as Kedi are focusing their efforts outside of Shanghai, with plans to move into other large cities such as Beijing, or into smaller but equally affluent cities in nearby Jiangsu and Zhejiang provinces. Foreign convenience chains have also targeted Beijing. The problems resulting from Shanghai's uncontrolled growth have made governments in other cities, particularly Beijing, more cautious with respect to the growth of convenience store chains. Although overall revenues for this industry are rising, per-store revenues have fallen.

Management of convenience stores is generally very good and procurement and distribution systems are heavily computerized. Distribution systems vary: some chains own their own distribution company, and some rely on a parent company's system, while others contract distribution out to a private company. Most chains calculate sales and order products on a 24-hour cycle while, though at least one operates on a longer cycle. Convenience stores offer a limited variety of goods, but nearly all have both refrigerated and frozen food sections and a growing number include microwave ovens. The emphasis is on impulse purchases of packaged foods and ready-to eat items such as ice-cream, dairy drinks, cigarettes and ready-to-eat foods such as tea eggs and hot sausages. Penetration of foreign foods is extremely limited. Falling per-store revenues, however, are causing many chains to seek ways to boost profits, including stocking higher value items. As a result, some chains are looking into the possibility of stocking more imported products. Convenience stores also offer a number of services such as bill-paying services and selling phone-cards. Services are offered at little or no cost, in order to bring customers into the stores.

Traditional markets continue to dominate China's 'other half', including most small cities and rural areas, as well as medium sized cities further inland. Wet markets perform multiple functions, acting as both retail outlets for daily shoppers and as secondary wholesalers for China's innumerable small restaurants. They also often serve as farmers' markets for local produce. Even in the largest, most advanced cities, wet markets persist, albeit at a much smaller market share than in other cities. A lack of inexpensive, high quality produce at many supermarkets and convenience stores, combined with longer distances to hypermarkets has created a niche for small wet markets and streetside vendors marketing fresh fruit, vegetables and meat. Likewise, xiaomaibus, small family-owned variety stores, fill a unique niche, being considerably smaller than even a convenience store and offering an eclectic mix of drinks, snacks, household items, hardware, bicycle parts and whatever else the owner thinks to stock. Even in convenience-saturated Shanghai the xiaomaibus persist, filling in the gaps between the most desirable convenience store locations or serving individual apartment buildings..

<u>There is no single model</u>: although dramatic, the pace of change in retailing is wildly inconsistent. For example, while Shanghai and Beijing are cities of roughly comparable size and income levels, Shanghai is much further along in the development of modern retail: hypermarkets are approaching saturation levels and convenience chains are struggling with cutthroat competition. Industry sources forecast that Shanghai will have over 3,000 convenience stores by the end of 2002. By contrast, Beijing has only a handful of chain convenience stores. Shanghai-based chains have plans to open several hundred stores in Beijing next year, but experts expect that growth will be much slower than in Shanghai. Beijing has a much more conservative regulatory environment, and a consumer culture that places more emphasis on personal contact than cleanliness and modernity. Differences like this can be found in cities throughout China. Although development is generally fastest on the coast, some inland cities such as Kunming have made surprising progress, while some large coastal cities such as Tianjin are lagging behind.

Future growth in the retail sector remains uncertain. The pace of development in any one place will vary depending on the local regulatory climate. The uncontrolled growth of convenience stores in Shanghai is viewed by many other localities as a failure, and it is likely that license approvals for chain stores will be harder to come by in the future. There are also indications that the Chinese government is growing less receptive to foreign-owned hypermarkets. Both Carrefour and Wal-Mart have seen expansion plans in China slowed during the past year by red-tape while Chinese competitors work to expand their market share.

Trends in food retailing are focused on time-saving measures. These span the range from offering ready-to-eat (RTE) products to growing sales of pre-mixed sauces and cooking mixes. Stores are offering a growing array of time-saving products that include frozen dumplings (packaged or sold in bulk), pre-cooked chickens and ducks, and packaged meal-kits that come with all the ingredients to make standard Chinese dishes, including meat, vegetables and sauces. Hypermarkets and department stores are also expanding their food alternatives by allowing vendors to open small kiosks selling hot snacks, or by partnering with fast-food outlets, such as Kentucky Fried Chicken, to include an in-house fast food restaurant. Western-style frozen dinners, however, have made little progress outside of supermarkets and hypermarkets frequented by foreigners, as few have been adapted to Chinese tastes. In addition to frozen and refrigerated cases, most convenience stores now include microwave ovens, creating a potential niche for single-serving frozen foods. Another significant development is the recent announcement that Lianhua and Carrefour will jointly open a chain of ‘discount’ stores. These stores will be somewhat larger than convenience stores and will carry a limited range of house-brand products offered at deep discounts.

Table 1. China's Top 12 Food Retail Chains in 2001
(ranking based on position among all retail chains)

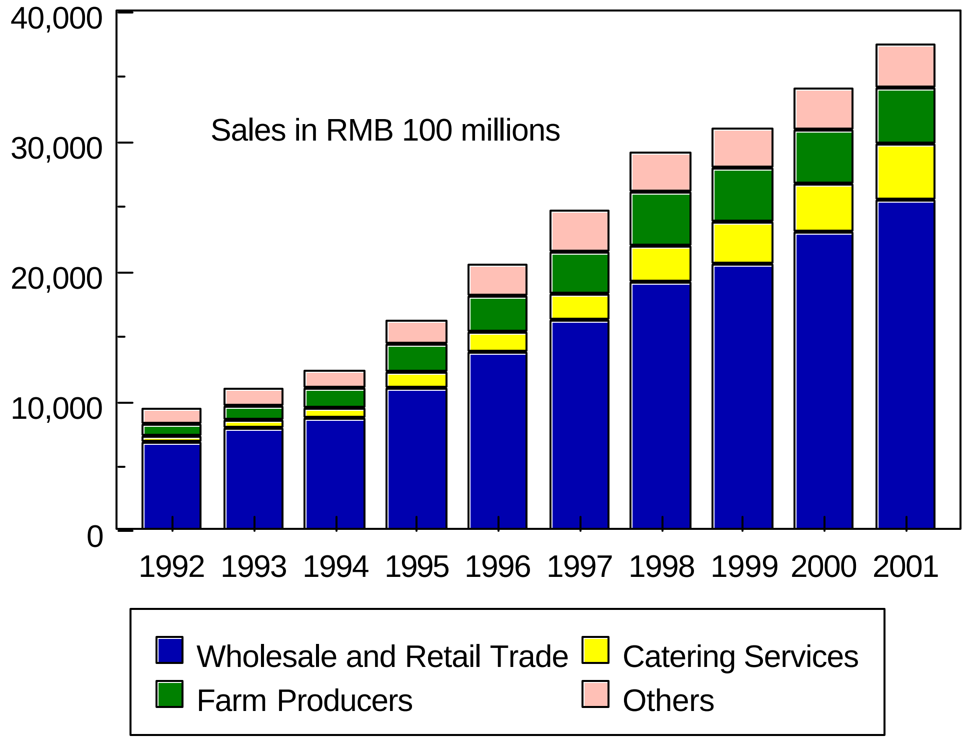
	Name	Business Line	No. of Stores	Revenue (Bill. RMB)
1.	Lianhua	supermarket, hypermarket, convenience	2,000	14.06
2.	Hualian	supermarket, hypermarket	818	8.50
3.	Beijing Hualian	hypermarket	42	8.00
4.	Nong Gong Shang	supermarket, hypermarket, convenience	325	7.47
na	Carrefour	hypermarket	27	6.00
8.	Suguo	supermarket	663	5.28
9.	Shanghai Metro	warehouse	15	4.94
11.	Huarun Wanjia	supermarket, hypermarket, convenience	343	4.64
na	Wal-Mart	hypermarket	17	over 3.00
14.	Jiangsu Wenfeng	warehouse, convenience stores	17	3.14
15.	Beijing Chaoshifa Tiankelong	supermarket, hypermarket, warehouse	101	2.63
17.	Beijing Wumei Grp.	supermarket, hypermarket, convenience	199	2.52

Note: These numbers reflect offical Chain Store Association (CSA) statistics. However, joint venture arrangements make these numbers somewhat deceptive. Carrefour's stores are operated under JV arrangements with several different companies, and do not appear in the official listing. Revenues for Carrefour and Wal-Mart are estimates. Some revenues from joint venture arrangements may also appear under a Chinese partners' earnings.

I.B. Retail Sales and Food Consumption Statistics

Detailed statistics on retail food sales are sparse, however there are statistics on overall retail sales. In 2001 total retail sales of consumer goods amounted to RMB 3.7 trillion ($455 billion). Growth in the retail sector has slowed in the past few years, but remains very strong. Overall retail sales grew at an average rate of 15% over the past ten years, but only at a rate of 8.7% during the past five years. The slowdown was less severe for retail and wholesale enterprises, which averaged 9.5% growth during that period, whereas retail sales by agricultural enterprises averaged only 5.3% growth. The catering sector posted the best performance, with retail sales growth averaging over 16.6% for the five years ending in 2001.

Graph 1. Retail sales of consumer-oriented goods in China, by sector

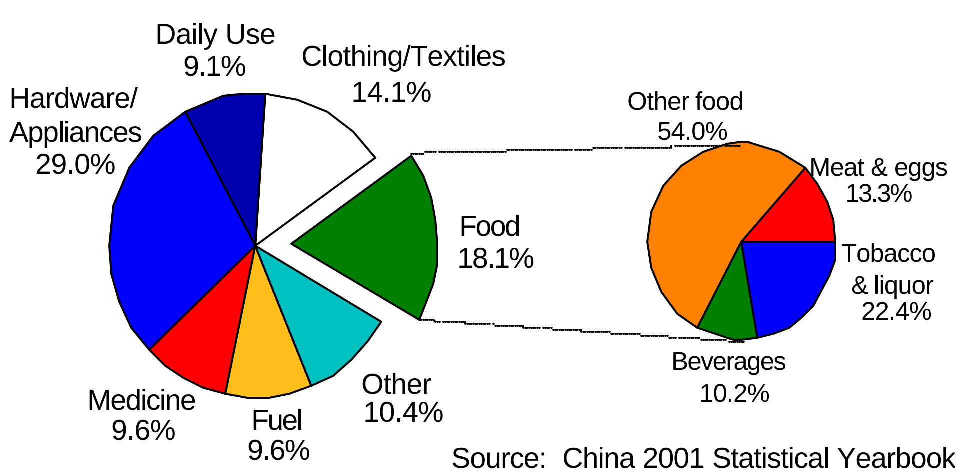


Source: China 2001 Statistical Yearbook

Additional statistics on retail sales indicate that, for larger retail operations (60 employees or more and sales exceeding RMB 15 million), food, beverage and tobacco sales accounted for nearly 18% of total sales, or RMB 136 billion ($16 billion) in 2001. Food sales by the retail trade increased by 10% over 2000.

Graph 2. Retail sales by enterprises of designated size, by category

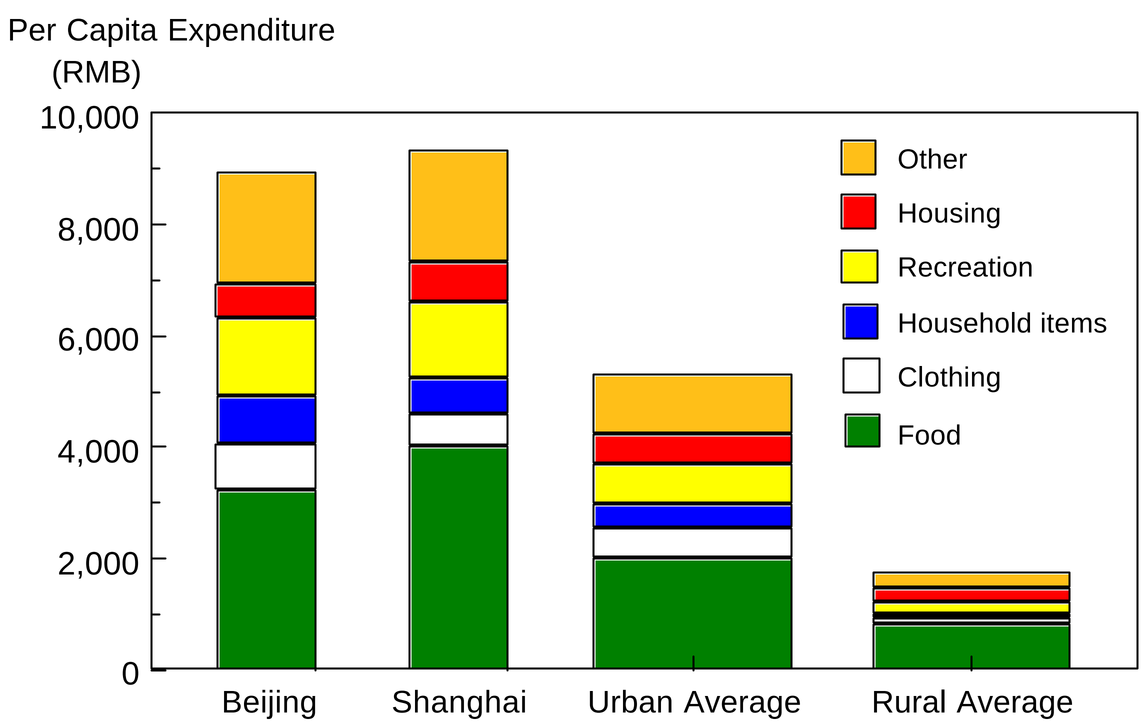
Sales by Retail Trade Only
(Total value equals RMB 751billion)



Source: China 2001 Statistical Yearbook

Statistics on consumer expenditures provide further insights, and reinforce the importance of targeting a specific demographic group. These statistics indicate an enormous gulf between urban and rural consumers, with urban consumers spending an average of 5,308 RMB ($642) apiece for living expenses, while rural consumers spend RMB 1,741 per capita–less than 1/3 of their urban counterparts. The difference is even more vivid when compared to the wealthiest cities: in Shanghai, consumers spend an average of RMB 9,336 per capita. Rather than falling off rapidly as incomes rise, expenditures on food remain a fairly high proportion of the total, particularly in Shanghai. In 2001 the average Shanghainese spent nearly five times as much on food as an average rural consumer.

Graph 3. Per capita annual living expenditures for selected market segments



Source: China 2001 Statistical Yearbook

I.C. Advantages and Challenges for U.S. Exporters in China

Table 2. Strengths and challenges for U.S. products in China's retail market

Advantages	Challenges
U.S. products are generally regarded as high quality by Chinese consumers.	U.S. products are routinely counterfeited.
Chinese consumers spend nearly half their income on food.	Chinese consumers are extremely price sensitive: U.S. products must compete against cheaper, more familiar domestic products.
U.S. brands are widely known and respected in urban Chinese markets.	Many U.S. processors have established plants in China, manufacturing U.S. brands in China using Chinese ingredients.
Incomes are growing rapidly and major urban centers such as Shanghai, Beijing and Guangzhou have large populations	Distribution and logistics are underdeveloped, making distribution of imported products to interior cities extremely difficult.
Food is a central part of Chinese culture, and consumers enjoy trying new tastes.	Lack of knowledge of many U.S. products and how to use/prepare them prevents consumers from buying.
WTO has reduced tariffs on many imported products.	Labeling and sanitary restrictions are subject to varying interpretations and haphazardly enforced.
The Agricultural Cooperation Agreement opened the Chinese market to many previously prohibited products from the U.S.	Many U.S. exporters rely on agents in China or Hong Kong for marketing. As a result, they have little direct contact with buyers.

II. Road Map for Market Entry

II.A. Ground Rules

There is no single formula for entering China: the best approach will vary depending on the product and the specific market being targeted. Nonetheless, there are some basic rules that apply in all cases.

K Invest (wisely!) in market research and testing

China is very different from other places. Tastes, customs, culture, business rules, government regulation are all different, and even experience from other markets will not necessarily transfer to this market. It is a good idea to test every aspect of a product: flavor, texture, packaging, shelf-life, price. At the same time, due to the absence of reliable government data and restrictions on public polling, the quality of research by most international market research firms is only marginally better than that of their local counterparts. Exporters with a long-term interest in China are well-advised to become familiar with the market and test the strengths of his product directly.

K Find a local Chinese partner and/or distributor

An exporter's success in China may hinge on his local partner/distributor/representative. There is no way to manage an export business for the Chinese market by remote control: business in China is based on relationships, and regular contact with buyers (distributors and retailers), consumers and government officials is crucial to success. Exporters choose one of several arrangements to establish representation in China: sign up a general distributor, set up a representative office, or form a joint venture or partnership with a strong importer/distributor. An exporter's choice should be made carefully, following a careful study of market conditions. Hastily made partnerships are perhaps the most common cause of business failure in China.

K Find your market segment or niche and focus on it.

China is big. Really big. Many exporters spread themselves too thin trying to cater to the entire market spectrum. Often, this is a recipe for disaster. It is important for an exporter to identify a target market (gourmands, health-conscious mothers, thrifty grandparents, etc.), and serve it faithfully and consistently until they are sure of their success. Exporters who spread themselves across too many market segments may find that they do not have enough resources focused on any one segment to have a significant impact.

K Pursue gradual but sustainable growth.

Another common pitfall is the temptation to pursue explosive growth (especially in geographic distribution and store penetration) in the first year or two, either to amass market share or to impress investors. This may produce good results if long-term demand for the product exists, but more often than not, exporters end up stretching their resources over vast and disparate geographic areas, and find themselves unable to focus on the requirements of local markets. In such cases, the sudden weakening of demand or the appearance of competition usually proves fatal. In addition, the go-slow approach provides exporters with time and feedback to fine-tune their products, marketing campaigns and distribution. Exporters are best advised to draft a less ambitious plan, expanding only on the basis of tangible success and real demand.

K Adapt your product to the Chinese market

Exporters should be prepared to adapt their products to the Chinese market. This includes flavors, package sizes, prices and labeling. Small changes to flavors or package sizes, based on market research, may make the product much more viable in China. Labeling is another major issue. China now has detailed regulations on food labeling, and enforcement of these regulations is getting stricter. Exporters are wise to invest in proper labeling for any product with long-term market potential.

K Invest in market promotion

Once in the market, an exporter's product will be competing with tens, if not hundreds, of other similar products. Domestic products will have advantages on price, consumer loyalty and brand recognition, while imports will be aided by aggressive advertising and promotion campaigns. Trying to match the advertising budgets of multinationals like Nestle or Kraft could be expensive. Nonetheless, marketing support is crucial to a product's success. Exporters must therefore design and implement their marketing campaigns carefully. Attending only quality trade shows and trade shows focused on your particular market segment is a good way to start. In-store promotions have also proven to be a cost-effective way to support an important distributor or retailer. Above-the-line media advertising should be carefully planned, as TV and radio time is expensive and has limited reach. Exporters are advised to explore joint marketing opportunities with local ATOs or with a State & Regional Trade Group (WUSATA, MIATCO, SUSTA & EUSAFEC).

II.B. Distribution and Logistics

Distribution and logistics channels vary significantly within and across all sectors, but have certain features in common. The basic outline for import logistics in China will be presented in this section while aspects peculiar to a retail outlet type will be noted later in this report.

- The channels that have traditionally supplied imported foods to the market (most notably gray market sales through Hong Kong) are notoriously opaque, unreliable and increasingly subject to crackdowns by the Chinese government. As WTO allows increased direct access to the Chinese market, gray market sales will decline in importance.

- Sales through agents in Hong Kong, long a key feature of the import market, are also likely to decline in relative importance. Exporters who are unable to afford the time or effort to market their products directly or to find a Chinese partner to do so are likely to continue using such agents. Companies with a long-term commitment to selling in China, however, will prefer to work directly with their distributors and buyers in the country.

- China is still subject to import licensing requirements and currency exchange restrictions. All imported products must pass through the hands of a licensed importer, at least on paper. Few distributors/traders have import licenses, and very few licensed importers act as distributors, so the licensed importer is little more than a legal convention, adding more paperwork (and fees, of course) to the whole process. Import licensing requirements are being loosened and will eventually be eliminated, but for the time being they must be dealt with. The licensed importer also typically handles the formalities of currency exchange. Even if payment is made on delivery, the entire process can take several weeks from the time the goods arrive to the time that the foreign exchange transaction is completed.

- The key task for an exporter is to identify a distributor that they can work with. This company must be able to handle all the import formalities (customs clearance, logistics, etc.) and have a network of retail customers. Because these companies rarely have either import or currency exchange rights, they must work through a licensed importer, typically paying 1-2% of the transaction value for their services.

- Once past customs and quarantine, products are usually stored in warehouses rented by the distributor. Storage costs are typically borne by the exporter, as distributors do not typically maintain inventories of products. As a result, most shipments arrive as consolidated container-loads ordered by one or more retailers.

- Once in the market, food products face a myriad of licenses required to sell in the retail market. All food products must receive a hygiene certificate from the local government, where the store they are listing in is located. Food products also have to be labeled in accordance with the latest labeling regulations. Functional or health foods must obtain a health-food certificate, and foods containing GMO ingredients may be subject to additional labeling requirements. Many of these regulations are vaguely worded, and enforcement is arbitrary and opaque.

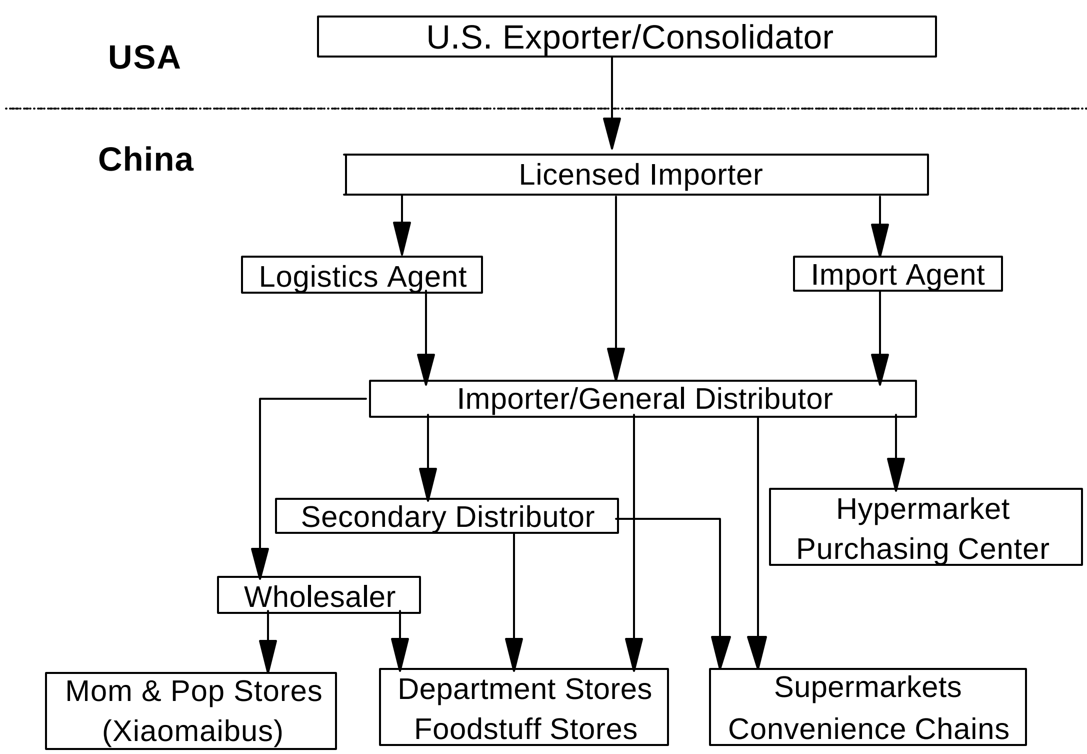
- In the past several years, a small number of service-oriented logistics companies, many of them with foreign participation and management, have been established in port areas and near free-trade zones. They offer a one-stop solution for companies interested in importing to or from China, including customs clearance, shipment handling and storage, bonded warehousing and foreign exchange clearance for imports. They are also able to dispatch products on demand, and maintain transparent international-standard accounting for their customers.

The following flow chart is intended to provide a simplified overview of the flow of goods from a U.S. supplier to a Chinese retail outlet.

Graph 4. Import distribution flow chart

The transactions involved in exporting to China can be extremely complex. The following flow chart presents the transaction flow for export of U.S. fresh celery to China. This should not be interpreted as a model for all transactions: these vary widely depending on the commodity and sometimes the buyer, particularly with respect to payment terms (many Chinese buyers will insist on 90 - 180 days credit). Nonetheless, it does provide some sense of how the import process works.

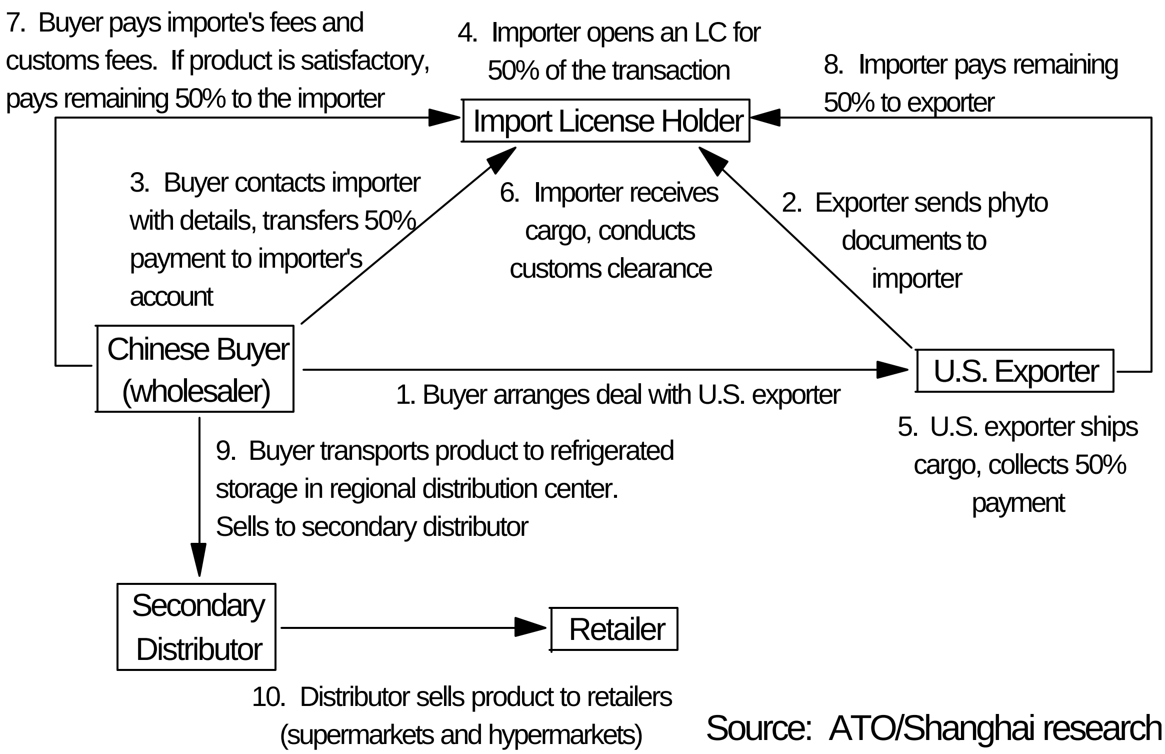
Graph 5. Import Path for U.S. Celery



Source: ATO/Shanghai research

II.C. Hypermarkets, Supermarkets and Warehouse Outlets

These larger, more centralized outlets provide the best opportunity for U.S. exporters. Dominated by chain stores, this sector has more centralized purchasing than most others and, at the hypermarket end, often involves foreign companies that are more receptive to imported products. Imported products are more common in hypermarkets than in any other retail format in China. Leading hypermarket chains



Source: ATO/Shanghai research

such as Carrefour and Wal-Mart, owe their success in part to the fact that they have managed to bypass China's inefficient wholesale system and are ordering directly from suppliers and manufacturers. For these buyers, distributors are typically handling logistics and import formalities but are not involved in marketing the products. Supermarket chains are more difficult targets, but the sheer size and nationwide reach of some chains makes them tempting targets.

Exporters interested in this market segment are best advised to familiarize themselves with their buyers: purchasing processes vary between different chains. For most hypermarkets and some supermarket chains, import purchasing is centralized in one way or another. Some handle all procurement aspects centrally, while others approve new products at the central office but allow local offices or stores to make their own import arrangements. Few of these chains have import rights, and must, therefore, work through licensed importers. Most source their products through distributors, though the details of the transaction are settled directly with the manufacturer/ exporter. For certain commodities (esp. wines and nuts), however, distributors play a central role in marketing the product to retail chains. Thus, depending on the product and the specific retail outlet being targeted, exporters may wish to focus their efforts on either a) the chain's central purchasing office, b) a distributor who can market the product for them, or c) both.

Promotions are most welcome among hypermarkets. Many chains such as Carrefour hold foreign food fairs on a routine basis and are constantly looking for new products with good market potential. Past experience indicates that promotions are best conducted on a regional basis. Fierce competition among food suppliers and manufacturers, struggling to gain shelf space at the best performing retail chains, however, has brought a new source of income for retailers: slotting fees. Retailers charge suppliers of consumer-oriented products a one-time listing fee for the opportunity to place a product on the shelves of their stores. Listing fees can be steep at the best retailers, such as Carrefour, reaching as high as RMB 10,000 per SKU per store. Additional charges are levied for prime shelf space and special off-shelf promotion space.

Table 2. Profile of leading hypermarket chains

Retailer	Ownership	Annual Sales (latest or estimated)	Number of outlets	Number of cities
Lianhua*	Chinese	RMB 14 billion*	28	- NA -
Carrefour	Sino-French	RMB 6 billion	27	15
Wal-Mart	U.S.	RMB 3 billion+	17	8
Nonggongshang*	Chinese	RMB 7.5 billion	20	- NA -
RT-Mart	Sino-Taiwanese	- NA -	14	7
Metro	Sino-German	RMB 1.8 billion	15	8+
Makro	Sino-Dutch	- NA -	4	2
Lotus	Sino-Thai	RMB 1.5 billion	5	2
Trust Mart	Sino-Taiwanese	- NA -	20	- NA -

Source: ATO Shanghai research
* Lianhua and Nonggongshang revenues include revenue from hypermarket, convenience and supermarket operations.

Supermarket chains are also open to promotions, but the larger number of stores involved and management issues make such efforts extremely time-consuming and difficult to manage. Again, the best results are usually obtained through smaller foreign-managed stores. The smaller number of outlets and solid management help to simplify arrangements and monitoring, and make it easier to evaluate the results.

Table 3. Profile of leading supermarket chains

Retailer	Ownership	Annual Sales (latest or estimated)	Number of outlets/cities	Principal locations
Lianhua*	Chinese	RMB 11.4 billion	700+/50	East China
Hualian*	Chinese	RMB 6.52 billion	606/NA	Shanghai, Beijing
Nonggongshang*	Chinese	RMB 7.5 billion	180/NA	Shanghai, Jiangsu, Zhejiang
Park 'N Shop	Hong Kong	- NA -	61/4	Guangdong
Wumart	Chinese	RMB 1.27 billion	102/1	Beijing
Suguo	Chinese	- NA -	170/3	Jiangsu

Source: ATO Shanghai research
* Lianhua, Hualian and Nonggongshang revenues include revenue from hypermarket, convenience and supermarket operations.

Chinese department stores form a separate market niche. Traditionally, most department stores have dedicated at least one level to food products. The format and management are similar to a supermarket, and most department stores are standalone operations. Though often owned by the same parent company as supermarket and hypermarket chains, these stores offer more limited opportunities to exporters. Most recently, however, some department stores have sought to reinvent themselves into small hypermarkets. These stores have expanded their product line to include fresh fruits, vegetables, meat and processed and RTE foods. The jury is still out on the success of these efforts in the face of stiff competition from dedicated hypermarkets and supermarket chains.

II.D. Convenience Stores

In their short history in China, convenience store chains have not provided the best opportunities for importers, particularly those bringing new-to-market products. Penetration by imports is extremely low, and consists primarily of dried fruit snacks and candy from Southeast Asia and Korea.

Management is often conservative with regard to product line, and places a very strong emphasis on widely-recognized brand names. The approach to promotions varies from chain to chain, though all appear to be conduct two-for-one type promotions, promotional (collect and win) games and set up POP displays. Convenience chains are particularly receptive to promotions that target their key demographics, such as schoolkids and working parents. None have expressed an interest in in-store tastings or giveaways, due to the organizational hassles involved.

Pressured by falling store revenues, convenience chains are looking for new ways to increase the value of the items sold. This includes stocking more high-value products and may include more imported products. The stores themselves offer a potentially good environment for promotion, although the large number of outlets makes it difficult to monitor. Purchasing is centralized, providing exporters with a single contact point to pitch their products. Displays are also standardized, making distribution and setup of POP materials considerably easier than with most supermarket chains. Promotions are likely to require close monitoring, but sales figures from the promotions should be relatively easy to obtain. For fast-moving items, most convenience chains work directly with manufacturers. However, for other items, they source most of their products through distributors. Exporters wishing to work with a chain will initially have to contact the distributor as well as the chain's management in order to ensure that their products are approved and stocked. Many chains negotiate deals with buyers on an annual basis, including prices and guaranteed minimum sales.

Table 4. Profile of leading convenience store chains

Retailer	**Ownership**	**Annual sales (latest or estimated)**	**Number of outlets/cities**	**Principal locations**
Lianhua*	Chinese	RMB 11.14 billion	1,000/50	Shanghai, East China
Kedi	Chinese	- NA -	680/9	Shanghai, East China
Liangyou	Chinese	900 million	470/1	Shanghai
Lawson	Sino-Japanese	RMB 76 million	78/1	Shanghai
Alldays*	Chinese	RMB 7.5 billion	500/1	Shanghai
7-Eleven	Sino-Hong Kong	- NA -	50/2	Guangdong

Source: ATO Shanghai research
* Lianhua and Alldays/Nonggongshang revenues include revenue from all hypermarket, convenience and supermarket operations. Lawson's revenue is separate from parent JV partner Hualian.

II.E. Traditional Markets

This category is a catch-all, including wet markets, wholesale markets, xiaomaibus and foodstuff stores. Although they represent widely differing formats, all of these outlets have a few qualities in common. Ownership is fragmented, and the outlets are largely unregulated. There are no promotions conducted at these outlets, and due to their sourcing practices there are few if any marketing opportunities. All are declining in importance. Few are relevant to exporters other than a few wholesalers of fruit and vegetables.

Wet markets are the traditional outlets for fresh meat and vegetables: both individual shoppers and small restaurants rely on them for daily supplies. Wet markets are declining in importance, but likely to persist for quite some time. Wholesale markets are a remnant of a quickly disappearing distribution system, though they are still strong in inland areas. Some imported vegetables and seafood occasionally make their way into wholesale markets for sale to hypermarket and supermarket chains, but otherwise import penetration is virtually nil. Xiaomaibus are the traditional mom & pop stores, much smaller than convenience stores and stocking a quirky array of daily-use goods including drinks, fruit and cookies. Although threatened by convenience stores, these persist even in convenience-store saturated Shanghai, particularly in locations considered undesirable by the chains. Strong customer loyalty also contributes to the persistence of the xiaomaibu. A program to convert the better-run xiaomaibus into convenience stores has seen limited success, but the stores remain extremely small with a limited variety of low-end goods. Foodstuff stores are a relic of the old state monopolies which sold a limited variety of packaged foods. Most have closed, although a few are attempting to convert themselves into specialty retailers carrying a particular type of food such as health food.

III. Competition

The most serious challenge facing U.S. food exporters is competition with Chinese or joint-venture counterparts. Supermarkets are frequently well-stocked with famous foreign brands, from Bugles snacks to Coca Cola. Virtually all of these products are manufactured within China. The quality and variety of domestically produced products has improved rapidly, and many are now able to compete with imports. Domestic products have completely cornered the market in several categories, including beer, soft drinks, processed meats and low-end confections. They are also providing growing competition in areas where imports were previously dominant, such as wine and fresh fruit. Chinese products have traditionally competed on price alone, but improved quality and efforts to develop identifiable brands have made domestic products increasingly competitive in these areas as well. For processed foods, Chinese producers also benefit from greater familiarity with consumers' tastes.

In the categories where imported products are prominent or predominant, competition is among the leading foreign suppliers. Few of these suppliers have permanent on-the-ground representation, and their marketing support usually depends on the level of involvement of their importer (usually a distribution agent or major retailer). For certain commodities leading exporters have managed to maintain a consistently strong market presence:

- Fresh fruit: U.S. (citrus, apples, table grapes), South Africa, New Zealand (kiwis), Thailand, Australia, Philippines (bananas)
- Beef: U.S., Australia
- Breakfast cereal: U.S.
- Cheese: Australia, France, U.S.

- Frozen potatoes: U.S.
- Butter: New Zealand
- Poultry: U.S., Brazil
- Premium chocolates: Switzerland, Belgium, Italy
- Premium ice cream: U.S.
- Seafood: Norway, Russia, Canada, Australia, U.S.
- Tree nuts: U.S. (almonds, pistachios), Iran (pistachios), Turkey (hazelnuts)
- Variety meats/offals: U.S., Canada, New Zealand
- Wine: France, Spain, Italy, Chile
- Low value seafood (Ribbonfish, cuttlefish, etc.): India

Tracking import shares is extremely difficult, as many products (particularly fruit and poultry meat) continue to move through gray market channels. WTO inspired reforms, however, are reducing the

importance of gray-market channels, and direct imports, particularly from Southeast Asia, are growing. According to U.N. data, the value of direct imports from Thailand doubled in 2001, while imports from Vietnam nearly quadrupled.

Graph 6. China's Direct Imports of Consumer-Oriented Agricultural Products, by Source

IV. Best Product Prospects

The best prospects category is a moving target.

IV.A. Products Present in the Market Which have Good Sales Potential

- Nuts and dried fruit
- Confectionary
- Seafood (fresh, chilled, frozen)
- Cereals
- Meat (fresh, chilled, frozen)
- Fresh fruit (citrus)
- Frozen vegetables
- Frozen foods
- Infant formula
- Pet foods

IV.B. Products Not Present in Significant Quantities, Which Have Good Sales Potential

- Baby food (from fruit and vegetables)
- Premium ice cream
- Ready-to-cook and ready-to-eat foods
- Private label foods and beverages
- Non-native berry products (cranberry, blueberry, raspberry)
- Fresh or frozen berries (raspberries, blueberries, blackberries)
- Ingredients and flavorings

IV.C. Products Which Are Present, but Have Poor Potential

- Beer
- Soft drinks
- Canned meat and fish
- Extruded snacks

V. Post Contact and Additional Resources

The Foreign Agricultural Service has several offices in China, in the cities of Beijing, Shanghai, Guangzhou and Hong Kong. Contact information for ATO/Shanghai follows:

Address: U.S. Agricultural Trade Office, Shanghai
Shanghai Center, Suite 331
1376 Nanjing West Road
Shanghai 20040, China

Phone: (86-21) 6279-8622
Fax: (86-21) 6279-8336
E-mail: atos@public.sta.net.cn or atoshanghai@fas.usda.gov
Website: www.atoshanghai.org

For further information about exporting to China, as well as upcoming events and activities, please visit the ATO Shanghai website, www.atoshanghai.org. Among the many reports available on the ATO Shanghai website are two that are recommended for first-time exporters to China: the *China Exporter Guide*, and *Business Travel in China*. Reports from ATO Shanghai and other ATO offices around the world are also available from the FAS website at www.fas.usda.gov.