

Required Report - public distribution

**Date:** 11/6/2003

**GAIN Report Number:** CH3615

# China, Peoples Republic of

## Retail Food Sector

### Report: South China

### 2003

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**Report Highlights:**

China's food retail sector continues to grow at a rapid pace and South China provides many export opportunities. Chinese consumers are interested in purchasing healthier foods than in the past and well-known American brands have good potential. However, many challenges remain in penetrating the market.

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Includes PSD Changes: No  
Includes Trade Matrix: No  
Annual Report  
Guangzhou [CH3]  
[CH]

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**Table of Contents**

<b>I.A. Market Summary .....</b>	<b>3</b>
<b>I.B. Year 2002 Statistic Figures of the Main Hypermarkets and Supermarkets in China .....</b>	<b>4</b>
<b>I.C. Advantages and Challenges for U.S. Exporters in China .....</b>	<b>5</b>
<b>II. Road Map for Market Entry .....</b>	<b>5</b>
A. Common Rules .....	5
B. Hypermarkets, Supermarkets and Warehouse Shops .....	7
C. Convenience Stores, Mini-Marts, Kiosks .....	9
D. Traditional Markets, Wet Markets and “Mom and Pop” Stores.....	10
E. Catering.....	10
<b>III. Competition .....</b>	<b>11</b>
<b>IV. Best Product Prospects .....</b>	<b>11</b>
<b>V. Post Contact and Additional Resources .....</b>	<b>12</b>

## I.A. Market Summary

Several retailing giants are aiming at entering the Southern China Market, especially the wealthiest province of Guangdong. Besides focusing on the leading cities such as Guangzhou and Shenzhen, they are now making considerable inroads into second-tier cities such as Dongguan and Foshan.

The entry of overseas-invested hypermarkets has had a great impact on the local supermarket industry. Local retailers are trying to compete with domestic and international rivals and trying to cope with the opening-up of China's retail market. However, instead of opening more shops, those local retailing giants are slowing down in expansion. The change could be attributed to the slow growth of revenues and fast dropping profit margins, and the difficulties in adapting to different corporate cultures while merging.

New suburban communities are changing the way people shop as well as how they live. Supermarkets are helping to shape the suburban landscape.

To maximize profits, retailers have conducted trials of vertical integration. They are partnering with manufacturers to produce or procure private label products, such as packaged foods, vegetables, and meats.

Retailers are trying to collect high amounts of slotting fees from suppliers to compensate for their lower income from sales due to fierce competition. However, the exorbitant slotting fees interfere with the suppliers' interests and have caused a sharp conflict between retailers and suppliers.

According to the latest Government Plan, the Central Government is encouraging the development of hypermarkets and supermarkets. However, learning from the experience of Shanghai on chain store development, the government is managing the pace of development to minimize possible failure. Thus, future growth remains uncertain and the pace of development will vary according to the local regulatory climate.

The penetration of imported foods is quite low in local markets. Generally, imported food has a less-than-five-percent-share of retail shelf space. This situation can be attributed to two main reasons: One, most of the retail stores lack import rights and therefore source locally; two, the implementation of bilingual labeling requirements creates more entry obstacles for imported foods, especially the packaged products.

It is becoming more evident that distribution channels in China will become more centralized, and the small and fragmented formats will have tough times ahead.

Consumer spending remains sluggish in comparison to the years before the Asian Economic Crisis in 1997. In addition, the Chinese Government is in the progress of reforming the pension and medical insurance system, which will require more input from individuals. Uncertainty about the future prevents people from spending more and provides an incentive for them to limit spending instead.

The outbreak of SARS in the region also changed buying habits and consumer tastes to some extent. Healthy and safe products are more welcome than ever. People tend to shop in cleaner and more reliable environments. On-line purchasing has also experienced an increase of sales. January through July sales for key Guangdong retailers were US\$2.2 billion (RMB18.4 billion), a 32.6 percent increase over those of the same period last year.

The newly signed "Closer Economy Plan Arrangement" (CEPA) between Mainland China and Hong Kong will lower the entry requirements for Hong Kong enterprises into the China market. More Hong Kong-based retailers are able to enter the market at a lower cost than before. With increasing competition, the battle of the shopping malls will most likely heat up.

Food and beverage retail sales are usually higher during holidays, such as the Chinese New Year (in January or February) and some other traditional Chinese holidays.

### I.B. Year 2002 Statistic Figures of the Main Hypermarkets and Supermarkets in China

Top 10 Hypermarket and Supermarket Chains in China (More than 20 outlets)			
Name	Business Line	NO. of Stores	Revenue (billion RMB)
Lianhua	Supermarket, hypermarket, convenience store	1883	18
Hualian	Supermarket, hypermarket	1080	12.5
Su Guo	Supermarket	940	7.02
Nong Gong Shang	Supermarket, hypermarket, convenience store	670 (convenience stores 480)	8.5
CRC Vanguard	Supermarket, hypermarket	450	8.59
Dalian Shopping Center Group	Hypermarket	51	10
Carrefour	Hypermarket	33	N/A
Xin Yi Jia	Supermarket	26	3.8
PriceMart	Supermarket, club store	26	N/A
Wal-Mart	Hypermarket, club store	25	1.47
HomeCity	Supermarket	24	0.27
Sources: Purchasing Magazine and ATO Guangzhou Research			

While the total number of outlets does not reflect the full picture of the chain stores, revenues provide a better understanding of potential profits.

2002 Revenue from Hypermarket and Supermarket Chains greater than 5 Billion (RMB)		
Name	Business Line	Revenue (billion RMB)
Lianhua	Supermarket, hypermarket, convenience store	18
Hualian	Supermarket, hypermarket	12.5
Dalian Shopping Center	Hypermarket	10

Group		
CRC Vanguard	Supermarket, hypermarket	8.6
Nong Gong Shang	Supermarket, hypermarket, convenience store	8.5
Su Guo	Supermarket	7.02
Metro	Warehouse store	5.6
Sources: Purchase Magazine and ATO Guangzhou Research		

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

Advantages	Challenges
American products are regarded as high quality products by Chinese consumers in Southern China.	Continued uncertainty about the future defers consumers from spending.
China's WTO commitments have lowered tariffs for imported products.	Non-tariff trade barriers, like labeling and sanitary restrictions, are making greater difficulties for imported products.
The country's major urban centers have sizable populations of relatively high income consumers, Guangdong province is one of the wealthiest regions.	Chinese consumers are very price sensitive; and the lifestyle of the Yuppies tend to eat out and seldom cook at home.
Continued expansion of infrastructure will support the distribution of frozen foods and products.	Infrastructure to support frozen foods and products still is uneven in development.
Superior packaging gives the impression of better quality.	Domestic production is improving in quality and marketing; and there are lots of counterfeit products in the market.
U.S. brands are widely known and respected in urban Chinese markets.	U.S. processors are establishing plants in China using Chinese ingredients as substitutes for their brand products.
Consumers enjoy trying new tastes.	Consumers lack knowledge of many U.S. products.
Great interest in American products on the part of both local distributors and retailers.	Fragmented information on U.S. products sources and contract practices.

## II. Road Map for Market Entry

### A. Common Rules

The retail sector is very alluring. In a nation of more than a billion consumers, the potential for profit is ever present. Mega retailers, domestic retail chains and small businesses are all vying for market share. Mall construction in first ranked cities, like Beijing, Shanghai and Guangzhou, and second-tier cities, like Shenzhen, Dongguan and Dalian, is booming and domestic supermarkets are even experimenting with overseas expansion. Guangdong as one of the wealthiest regions in the country is also the main market attracting the chain stores. There is no single formula for entering the market; the best approach will vary depending on the product and the specific market being targeted. Nonetheless, some basic rules apply in

all cases. Please contact our office directly for more information on how we can be of service to U.S. companies interested in entering the South China market.

- Get to know the market

The real barriers to bilateral trade between China and the U.S. are information inadequacy: mutual lack of knowledge of each other's products and business practices. In general, Chinese buyers are not familiar with U.S. product sources and contract practices. U.S. exporters do not know the Chinese market, especially its sales and distribution channels and customers' preferences. Face to face contact is the most effective way to resolve this problem. It is relatively easy for Americans to visit China. To enter the China market, you need to come prepared. Establish the price range of your products, and print your business cards and product information in both Chinese and English.

- Find a local partner or agent

An exporter's success in China hinges on the right local partner or agent. Look for someone with a proven record (reputation, business registration, taxation) in a specific business and with a sales and distribution network. The partner must be able to handle all the import formalities and pay for the imported products by remitting hard currency to the exporter. The local partner should take care of in-country cash transactions (cash flow and credit for retailers), customs duties, VAT, in-country transportation and storage of products, insurance, quarantine and marketing the products. Exporters should choose representatives slowly and carefully.

- Test the market

Everything is different in China – tastes, customs, culture, infrastructure, and business rules. Even the most successful, experienced business would be wise to devote ample time and resources to identify and study a target market. ATO Guangzhou provides Product Assessment Support Services to help U.S. exporters test market acceptance of their products.

- Find your market segment and focus on it

Faced with the enormity of the Chinese market, some exporters attempt to diversify too much, too early, trying to cater to the entire market spectrum. Often this is a recipe for disaster. The most effective approach is for the exporter to identify and develop a niche market.

- Adapt your product to the local market

China is a big country; tastes and preferences vary by region. Exporters should adapt their products to local tastes. Small adjustments based on market research may make the product much more viable in the Chinese market.

- Invest wisely in market promotion

Join the trade missions of your products. Attending only quality trade shows is a good way to start. Once in the market, in-store promotions have also proven to be a cost-effective way to support the retailers. Be present in China regularly. Explore joint market promotion opportunities with the ATO office or with a State and Regional Trade Group(s).

## B. Hypermarkets, Supermarkets and Warehouse Shops

China is not fully open to imported products. Imports are controlled through quotas, import rights, and the not fully convertible Chinese currency. Most retailers in the market lack importation rights. As a result, they can only purchase imported food and beverage products from local distributors or wholesalers. Many distributors in Southern China use companies based in Hong Kong to supply them with imported products. Some others try to rent or trade import rights with the import companies. Usually the import companies will charge 1% to 2% of the total transaction value as a service fee. However, this system makes it difficult to assess whether a potential distributor would make a viable and reliable partner.

Under its World Trade Organization (WTO) commitments, China is obliged to fully open its wholesale and retail markets by December 11, 2004. China's distribution channels are still being reformed to meet the WTO demands. The Chinese government is granting import and export rights to more companies as they meet certain criteria. Many privately-owned companies have received import rights because of their strong market oriented business methods and increasing power in the market. The privately-owned companies are more price-sensitive and realistic; they tend to have a strong wish to set up business relations directly with the exporters and manufacturers and would like to keep the relationship for the long term.

The hypermarket format, pioneered by such retail giants as Wal-Mart, Carrefour, and Metro, is driving the latest phase of the retail revolution. Chinese consumers can get almost everything they need, from fresh fruit and dry groceries to clothes, household goods, or even electronics, in the same superstore. In viewing the success of those hypermarkets, the food area is the core of the hypermarket. In addition to extensive arrays of traditional food products, like dry and frozen foods, the food area in the hypermarket boasts a sizable fresh section, featuring fruits, vegetables, meats and seafood. The food area is the main attraction for customers visiting the hypermarkets. Surveys have shown that consumers are increasingly willing to purchase goods in large retail stores. Many Chinese consumers are more and more willing to pay a little more for well known western brands for quality and food safety reasons.

Hypermarkets adopt a centralized purchasing strategy, which helps to reduce costs drastically. The heavy engagement of computer logistical systems also helps the hypermarkets to keep prices low by holding down warehousing and storage costs. Hypermarkets usually order directly from large suppliers and manufacturers. Imports, which account for 5% or less of their sales, are sourced through established import agents or general distributors. It is difficult for new suppliers, especially small- or medium-sized suppliers to break into the hypermarket chains. To get into the hypermarket, you will be charged high slotting fees and numerous in-store promotion activities charges follow. Most retailers also impose burdensome credit terms on suppliers, commonly demanding payment in 30 – 90 days. Thus the supplier is not really enthusiastic about introducing new products into the market, unless they record satisfactory sales on a trial basis. Promotions are most welcome among hypermarkets. Depending on the product and the specific retail outlet being targeted, exporters may wish to focus their efforts on either the retail chain's central purchasing office or a distributor who can market the product for them.

The rapid expansion of big stores, especially hypermarkets and supermarkets, into fast-developing outskirts and suburban residential zones, is also a result of recent market developments. Increased incomes, fast-paced demanding lifestyles and increased automobile ownership are the main reasons for the trend. The presence of giant retailers is sparking a wave of changes in suburban commercial areas, infiltrating what was once the domain of community chain stores. With more and more car owners, particularly young people buying

suburban housing, the consumption capacity in suburban areas is much higher than the average in downtown areas. As distinct from whereas people shop in downtown areas for relaxation and are mainly window shoppers, stores in the suburbs have a client base that wants a supermarket nearby where they can buy food and other necessities. Metro from Germany will open a new shop in Dongguan by the end of this year and it plans to open 7 to 8 new shops in the Pearl River Delta within the coming 5 years. Hutchinson Whampot Ltd., the owner of Park'n shop and Watson's Bodycare shop, plans to bring in Fortress World, an appliances shop and Watson's Wine into the market. At the same time, Chinese companies are slowing down their pace of expansion; instead they are now seeking to improve their profit-making capability. CRC (China Resources Cooperation) recently announced that it will temporarily stop buying and merging with more retail outlets and will focus on improving the profit-making capability within its current retail outlets. Min Run (People's resources), which acquired DaoneiJia and is now known as PRDNJ, has also made a similar decision to slow down its pace in expanding.

Company Profiles: Selected Hypermarkets and Hypermarkets in Guangdong Province (Jan. 2003 to May 2003)					
Retailer	Ownership	Total Sales (RMB)	Number of Outlets (as of Dec. 2002)	Location	Relative sales efficiency per outlet (RMB)
CRC Vanguard	Chinese, Shenzhen based	42.1 billion	450	Guangzhou, Shenzhen, Dongguan, Beijing	9.35 million
Xin Yi Jia	Chinese, Shenzhen based	15.6 billion	26	Guangzhou, Shenzhen, Jiangmen, Jinan, Nanjing	60 million
Park'n Shop	Hong Kong	897 million	8	Several Guangdong cities	112.1 million
Trust-Mart	Taiwan, Guangzhou based	827 million	11	Guangzhou	75.2 million
Wal-Mart	U.S., Shenzhen based	655 million	25	Shenzhen, Dongguan, Kunming, Changchun	26.2 million
Makro	Sino-Dutch Joint Venture, Guangzhou based	362 million	3	Guangzhou, Shantou	120.7 million
Jusco	Sino-Japanese Joint Venture, Guangzhou	179 million	5	Guangzhou, Shenzhen	35.8 million



	based				
Homecity	Chinese, Guangzhou based	109 million	25	Guangzhou	4.54 million
Carrefour	Sino-French Joint Venture, Shanghai based	N/A	33	Beijing, Shanghai, Guangzhou, Qingdao, Haerbin, Kunming	N/A
People's Resources and Dao Nei Jia	Chinese, Shenzhen based	10.1 billion	21	Guangzhou, Shenzhen	48.1 million
Sources: Purchasing Magazine No. 6, 2003 All listed supermarkets and hypermarkets rely on agents and distributors for purchasing products.					

### C. Convenience Stores, Mini-Marts, Kiosks

Despite their short history in China, convenience stores are making highly successful progress in China. Many convenience store chains are now expanding quickly to increase their market share. Kedi, one of the Shanghai based chains has set up a regional logistic center in Guangzhou and opened 2 stores in Jan. 2003. Quik, a subsidiary of Lianhua Co. the biggest Chinese retailer, is going to operate mini-marts at SinoPetroleum gas stations across the country. Those mini-marts will start from the wealthiest region, like Guangdong and Shanghai, and then enter other provinces at a later date. The main competition faced by the convenience stores and mini-marts comes from the thousands of kiosks that dot the cities, not supermarkets and hypermarkets. Because of the increased area foot traffic created by the supermarkets and hypermarkets, the large stores tend to generate more business to the convenience stores than they take away.

The increased competition has also helped the chains find their market niche. 7-Eleven, the world's largest convenience store chain has recently come to an agreement with the Guangzhou Metro Company to set up 91 stores in subway stations in the two currently operating subway lines. This will be the first convenience store chain operating in the subway station. 7-Eleven is also planning to open another 36 stores in the Shenzhen subway station after it goes into operation in the coming years. Considering the limited time each customer may stop at the store and the limitation of space, the chain has decided to mainly focus on offering breakfast, beverages, batteries and newspapers in the subway stores. Phone cards will also be available for sale.

The customer base for convenience stores and gas station mini-marts tends to be different. While convenience stores attract young people, mini-marts tend to rely on drivers and passengers of almost all ages. The different customer bases lead to product differences in each type of store. Convenience stores put a great emphasis on ready-to-eat foods, snacks and newspapers; gas station mini-marts usually offer only some soft drinks and locally branded packaged products along with vehicle products.

Market entry and distribution methodologies for convenience stores and mini-marts are about the same as for supermarkets and hypermarkets. Most of the chains benefit from their centralized purchasing system. These stores mainly stock imported or joint venture produced candy, snacks, alcohol, and cigarettes. Convenience stores earn sizable revenues from prepared foods such as hot dogs, dim sum and ice cream. The foreign convenience store

chains usually buy product on credit, while kiosks often pay in cash. Both convenience stores and kiosks generally sell the same types of products, but people often feel the product quality in convenience stores is higher and reliable, while the price is higher too. The convenience stores tend to specialize in prepared food items but no fresh fruit while some kiosks' situation is the reverse.

Company Profiles: Convenience Stores in Guangzhou		
Retailer	Ownership	No. of Outlets
7-Eleven	President/Tianwan (franchise holder)	126, another 25 stores in subway stations
Kedi	Dairy Farm/Hong Kong	13
Quik	Lianhua/Chinese	65
BP Service Station Convenience Stores	BP/PetrolChina	140+ (30+ in Guangzhou city and surrounding area, the others are mainly scattered along the Guangzhou-Shenzhen express highway and Shenzhen-Shantou express highway)
OK	Ya Li Group/Hong Kong	4
Sources: ATO Guangzhou Field Research		

#### D. Traditional Markets, Wet Markets and “Mom and Pop” Stores

These types of stores and markets are still popular among local consumers, but some of them are transforming into supermarket-like stores. Their numbers in Southern China, especially in large cities, are decreasing. Because of the large low-income population and the influence of traditional cuisine culture, wet markets remain the main source of meat and vegetables. In general, Chinese people tend to think that the meat and vegetables found there are cheaper, fresher and more varied than the supermarkets. Some imported products find their way into these places, but by the time they reach this level all knowledge of their origin is usually lost. Any market entry strategy focusing on these places would be a futile effort.

The local governments, in an effort to improve overall urban sanitation, are closing and consolidating these markets, especially the wet markets. The authorities plan to transform the wet markets into supermarket-style places, where consumers can buy meat, vegetables and daily necessities in a cleaner and more sanitary environment. To compete, the supermarket chains are setting up relatively large fresh food areas to attract consumers. It is predicted that this competition will continue for the next 5 to 10 years.

#### E. Catering

There are two different forms of catering in the Chinese market right now. One is catering to private customers; the other is institutional catering. Compared to all other retail formats, the catering service to private customers is a relatively new retail form in China. Only some five-star hotels and a few foreign-owned companies are in this market. As the catered customer's income level is usually high and the material requirements are strict, many imported products and ingredients may be used. However, many of these catering firms are not willing to use imported products due to higher costs. Almost all the foreign-owned

companies have their own sources of supply and the demand for high quality imported catering products has not yet been established. Exporters who wish to focus on this market need to cultivate the five-star hotels for product penetration. ATO Guangzhou's American food menu promotion in selected restaurants and hotels might be viable for some U.S. food exporters to participate.

The other format of catering, institutional catering, has a much longer history in the local market. The airline industry is one of the biggest players in this market. Almost all the airlines have their own menu and cost requirements for the catering companies. Chinese airlines are reluctant to spend too much on food at this time since airline food service is still being developed. Therefore, it is difficult for imported products to compete in this niche market due to their generally higher costs.

### III. Competition

The most serious challenge faced by U.S. food exporters is competition with Chinese or joint-venture food or food processing companies. The quality and variety of domestic products has improved rapidly, and many are able to compete with imports. Chinese products have traditionally competed on price alone, but more and more are able to compete in terms of quality and marketing. Some Chinese producers are using imported ingredients to improve the quality of their products and are adept at learning from their overseas competitors' successful marketing strategies.

China's food and beverage industry is well developed and there are many joint venture competitors with local manufacturing plants which compete favorably against imports. Coca-Cola, PepsiCo, Nabisco, Quaker Oats, Kraft, Heinz and Budweiser have all established manufacturing plants in China. Other American companies have also expressed interest in establishing plants here in the future.

Besides the competition from local competitors, U.S. imported foods also face strict food safety requirements from the Chinese government. The bilingual labeling requirements of imported products and GMO restrictions all raise obstacles to the entry of imported products.

America is just one of the key players in the South China market. Many other countries have set up trade promotion offices in Guangzhou which are active in their own market promotions. The most prominent are Australia, Canada, France, Great Britain, Italy, the Netherlands, New Zealand, Thailand, Malaysia and the Philippines. Direct imports from Southeast Asia are on the rise.

### IV. Best Product Prospects

A. Products present in the market which have good sales potential

- Consumer foods
- Health foods and beverages
- Flower bulbs
- Seedling and nursery products
- Food for infants, nursing mothers, school children, and older people
- Pasta and sauces
- Nuts and snacks
- Fresh fruit
- Red meat and poultry meat
- Dairy products
- Salmon and crabmeat

- Pet food
  - Frozen French fries
- B. Products not present in significant quantities, but which have good sales potential
- Baby foods, particular those made from fruits and vegetables
  - Ready-to-eat and ready-to-cook foods
  - Chicken meat
  - Cheese
  - Vegetarian foods
  - Fish oil
  - Wine

#### V. Post Contact and Additional Resources

U.S. Agricultural Trade Office in Guangzhou

Address: U.S. Agricultural Trade Office, Guangzhou  
China Hotel Office Tower 14/F  
Guangzhou 510015, China

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You may use our ATO Guangzhou Office to arrange on-site meetings with South China traders and to participate in local market promotion events.

For further information about exporting to China, as well as upcoming events and activities, visit the ATO Guangzhou website at [www.atoguangzhou.org](http://www.atoguangzhou.org). Current information on the South China market and reports on the food processing sector, the hotel and restaurant sector and the retail business sector are available from this website.