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# China, Peoples Republic of

# Market Development Reports

# Out on the Town: China HRI Sector Update

# 2002

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**Report Highlights:**
**China's food service sector has grown remarkably over the last six years. Rising incomes and changing living patterns have encouraged more people to eat out. Food service in developing coastal cities is beginning to follow the pattern set by Tokyo, Hong Kong and Singapore, as more Chinese develop a taste for Western food. However, while the market is large, the percentage that can afford imports remains small. While t is complicated and sometimes frustrating to work in the extremely competitive Chinese market, excellent opportunities exist for U.S. exporters.**

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## I. Market Summary

### A. Overview

China's ongoing economic liberalization and urbanization have accelerated growth within the food service sector while creating a new class of increasingly sophisticated consumers. As Chinese diets broaden to include new flavors and foreign ingredients, agricultural producers around the country and around the world are scrambling to earn a share of this WTO-enhanced dream market. While many foreign companies and producers have lost money in China's enormous, but often elusive market, focused market intelligence and deliberate planning have helped select American producers

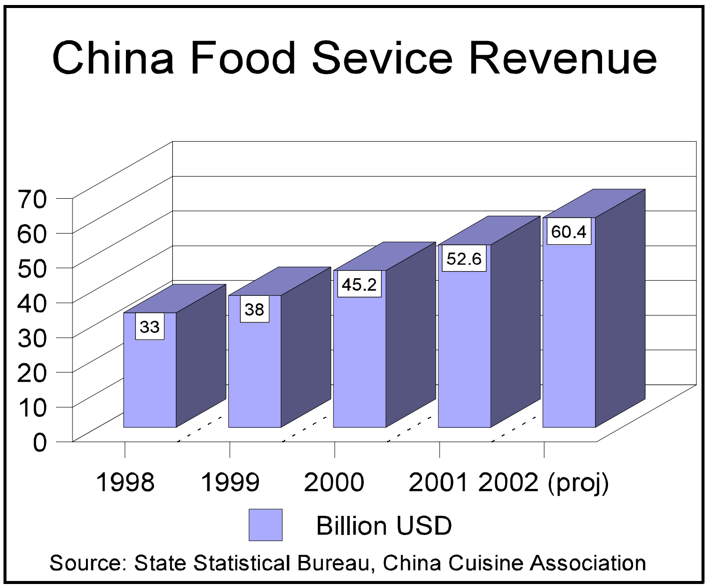



**Figure 1** – Chinese food service, annual revenue, 1996-2002

capitalize on specific, timely opportunities.

As China continues its shift from socialism to a market-oriented economy, GDP and income levels are rising. Within the food service sector, this transformation has resulted in the abandonment of communal "iron rice bowl" distribution in favor of increasingly diverse private enterprises. Indeed, State Statistical Bureau data indicate that Chinese food service sector revenue has almost doubled since 1998, with an average 15% annual growth rate over the past five years. As of 2000, 36% of large restaurants in China were foreign owned/invested (see fig 2).

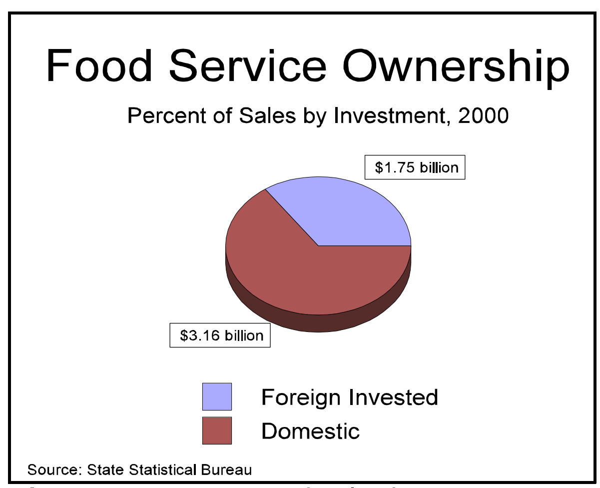
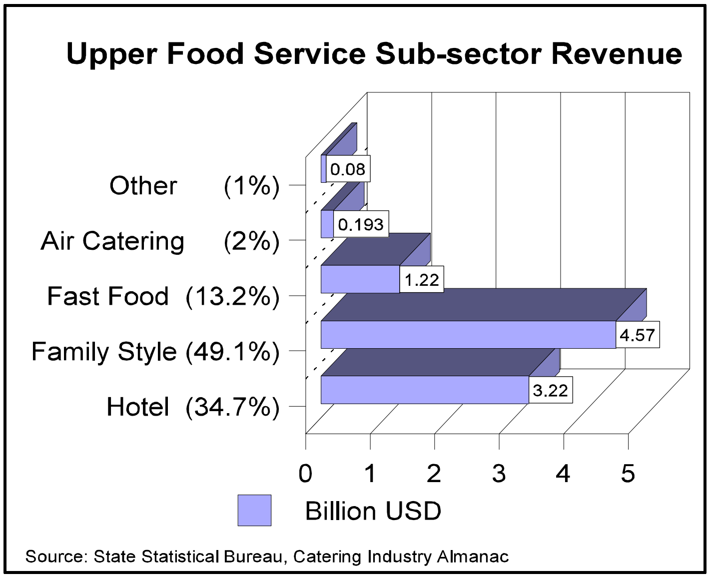



**Figure 2** – Percentage of Sales by Investment, 2000; restaurants with more than 30 employees or above $240,000 in annual sales

The HRI sector

offers diverse opportunities to American agricultural producers. While five star hotels serve the highest value items with the fattest profit margins, China's restaurant and institutional sectors dominate food service in terms of breadth and gross revenue. Nonetheless, the small restaurants and cafeterias that feed China's masses are extremely price sensitive, even among local suppliers. Unless a business relationship




has already been established with a five-star hotel, fast food and family style restaurants that target privileged only children and the emerging middle class present the best prospects for American producers hoping to enter China's food service sector.

The geographic and sociological unevenness of economic development (and openness to imported products) throughout China creates unique opportunities for patient and deliberate exporters. Significant foreign investment in the food service sector and a dominant restaurant sub-sector suggest that China is structurally poised to introduce new flavors and ingredients to the increasing number of middle class consumers. Moreover, the growing taste for Western food among more prosperous cities heralds new and expanded markets for American producers.

**B. Market Drivers**

- Growing Chinese taste for Western food.
- Curiosity, status-seeking
- Increased food quality in Chinese restaurants
- Demand for safe, healthy food
- Private investment

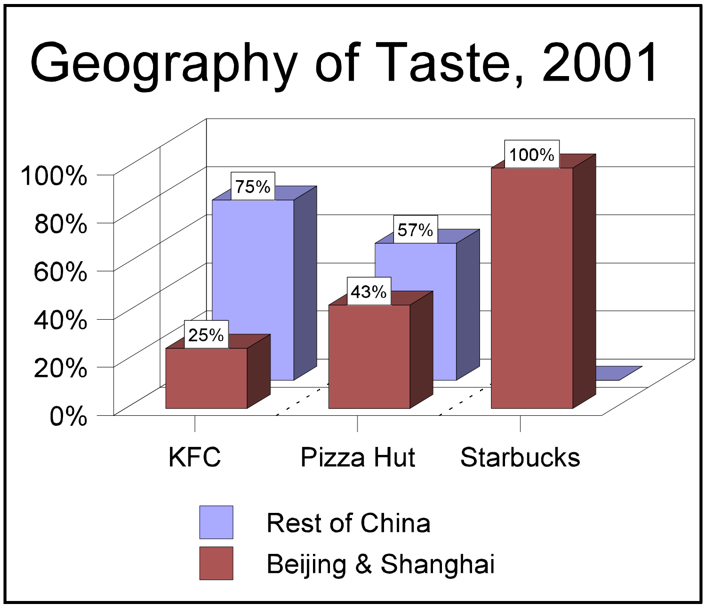
**Figure 3** – Food Service Sub-sectors; Tourist hotels (1-5 stars) and restaurants with more than 30 employees or above $240,000 in annual sales.

- Changing structure and scope of market
- WTO tariff reductions

- Growing expatriate community
- Tourism, including run-up to Beijing Olympics

Key market drivers in the food service industry emerge from the basic economic and sociological forces operating in China. The country is urbanizing, growing more prosperous, and beginning to integrate its previously insular and regionally divided economies with the global economy.

Native Chinese among industry insiders are unanimous about the biggest factor




favoring higher future food imports: the expanding taste for Western food. Young Chinese in major cities are growing up eating Western fast food. Fast food outlets like KFC and McDonald's have spread across the country, while higher level outlets like Pizza Hut are still largely limited to coastal cities. In Shanghai and Beijing, Starbucks and Haagen-Dazs shops have become trendy places to meet or date, but have yet to spread much beyond those two cities. Starbucks says 70% of its customers are upwardly mobile Chinese urban white collar workers.

The contrasting geographical emphasis among KFC and Starbucks, two of the most successful foreign service companies in China, illustrates the availability of opportunities at varying points along the country's developmental curve. While KFC targets a large, lower market niche that extends to cities throughout the country, Starbucks must rely on cosmopolitan consumers willing to pay a premium for their bourgeois experience. Pizza Hut falls somewhere in between in that it is selling an experience as much as a particular kind of food, though it's priced to appeal to a larger segment of diners. These companies are taking advantage of some of the diverse opportunities created by the market drivers listed above.

**Figure 4 –** Distribution of Select US-based Restaurants in China

| | 2001 Beijing & Shanghai | Rest of China, 2001 | Beijing & Shanghai, New 2002 | Rest of China, New 2002 |
|---|---|---|---|---|
| KFC | 142 | 436 | 30 | 120 |
| Pizza Hut | 26 | 34 | 9 | 30 |
| Starbucks | 48 | 0 | 16 | 6 |

**Figure 4a** – Numbers of Outlets In Beijing/Shanghai vs. Rest of

Experienced Asia hands see China's expanding taste for Western food as a familiar pattern. Shanghai appears to be following a track blazed by Tokyo, Hong Kong and Singapore, where international food is a fully realized alternative to traditional cuisine. Beijing and Guangzhou are also beginning to fit this pattern, but other Chinese cities are much further down the curve.

Chinese restaurants, even at the high end, still use little imported food, both because imports are expensive and because Chinese cuisines are well-developed and particular in taste. Xiaonanguo, a Shanghai-based chain that buys more than RMB 60 million (USD 7.3 million) worth of food inputs a year, uses about 5% imported product by value, mostly prestige items like seafood, beef and wine. Jinjiang Hotel Group uses 7-8% of its approximately Rmb 100 million (USD 12 million) group food budget for imported products, mostly for Western restaurants in its five-star hotels.

The vitality of the restaurant business in China comes partly from the fact that it is one of the few viable outlets for private investment. Hotels and restaurants barely existed as a sector only 25 years ago, so supervision is less bureaucratic. Small restaurants can be founded by families with little capital and growth can be funded from revenues, important for entrepreneurs because the state banking system rarely lends money to private citizens. Significant chains like Xiaonanguo have sprouted from small investments in street restaurants. In addition, many government departments and the large, state-owned enterprises that used to dominate the economy are shutting down or spinning off their food operations, creating opportunities for private restaurants, food delivery services and caterers.

Elite consumers in China have picked up on international concerns about hygiene and health, leading to notably cleaner environments in competing Chinese restaurants. In a 2002 survey by a Beijing catering company, 70% of respondents said health and safety are important factors in food choice. This new awareness creates opportunities for foods that can capture the health and safety issues.

Food imports will also get a boost from China's accession to the WTO, as tariffs are scheduled to plunge on a large number of items. These cuts will make a significant dent in the price advantages enjoyed by competing local products, which usually cannot match the foreign product's quality. (See Appendix I, Tariff Chart).

The growing international community is important to the economic survival of foreign-style restaurants, and it has also introduced new cuisines and new ideas to

Chinese palates. The community includes Westerners, Japanese, Koreans and hundreds of thousands of Hong Kongers, Singaporeans and Taiwanese, who import both foreign tastes and experimental "fusion" cuisines.

Tourism is also expected to continue growing sharply with the approach of the 2008 Beijing Olympics. The State Tourism Bureau has announced an Rmb 200 billion (USD 24 billion) budget for new facilities and services. Beijing currently has 21 five-star and 43 four-star hotels (out of 506 starred restaurants total), and 44 licenses have been issued for new four- and five-star restaurants to be built by 2005. Last year, China's income from international tourists reached $17.8 billion, while domestic tourist income grew to more than $42 billion. The World Tourism Organization reports that China led Asia in overseas tourist arrivals in 2001, fanning the flames of China's hot food service sector.

A wave of new restaurants catering to foreigners, Taiwanese, Hong Kongers and trendy Chinese has opened in Shanghai and Beijing in the last two years. Hot trends in Shanghai include Brazilian or Latin barbeque restaurants, with 17 opening since the summer of 2000, along with 49 Cantonese restaurants catering to Hong Kong transplants. Thirteen pizzerias, 15 Italian, 29 Continental/Fusion, and 31 Japanese restaurants have also opened in the past two years. In Beijing, culinary trends over the last two years have added 24 new Cantonese, 16 Sichuan, 14 Japanese, 14 Italian restaurants, and 11 pizzerias. In addition, about 70 new coffee shops or cafes have opened in each city, including more than 40 Starbucks outlets

The new restaurants and the local bar scenes have helped encourage increased imports of quality wine and bottled water, although those imports start from a very low base. Coffee imports jumped 75% in 2001 to 9,468 tons, still a very low percentage of the world coffee market.

**Figure 5** – Shanghai and Beijing Consumer Magazine Restaurant Listings

| Western: | Listed July 2000 | Closed by 2002 | New Since 2000 | Listed as of July 2002 |
|---|---|---|---|---|
| Beijing | 174 | 96 | 187 | 265 |
| Shanghai | 140 | 50 | 216 | 306 |
| Total | 314 | 146 | 403 | 571 |
| High-End Chinese: | | | | |
| Beijing | 92 | 54 | 96 | 134 |
| Shanghai | 114 | 25 | 122 | 211 |
| Total | 206 | 79 | 218 | 345 |
| Grand Total | 520 | 225 | 621 | 916 |

Source: Beijing City Weekend, That's Shanghai

### C. SWOT Analysis for U.S. Food Imports

| STRENGTHS | WEAKNESSES | OPPORTUNITIES | THREATS |
|---|---|---|---|
| Popularity of U.S. culture extends to food; U.S. fast food leads way in introducing Chinese to Western food | Chefs and consumers need education in quality, taste and use of U.S. food products; initial incentive to use local products | Increased awareness and consumption of Western food; younger people moving up the chain to higher-quality food | Competition in import market from Europe, Australia, Brasil, & domestic Chinese production |
| WTO-required tariff reductions make U.S. imports more competitive | High price limits U.S. imports to Western restaurants, five-star hotels and high-end Chinese restaurants | Rising incomes, busier lifestyles mean people have more money to spend on eating out | Protectionist impulses and abrupt policy changes raise non-tariff barriers to imports |
| Reputation for consistently high quality, reliable supply | Long lag time between product order and delivery; high trans-Pacific shipping costs | Air catering, tourism, international schools, resorts and golf clubs are all growing sectors | Domestic replacement as Chinese food and ag industry develops and internal transportation improves |
| Strong brands in a low-brand environment | Fragmented domestic market, poor distribution network complicate market entry | Improved intellectual property protection should help brand opportunities | Fake products take market share and damage brand images, particularly through the grey channel |
| U.S. recognized as leader in food service techniques and management | Cheap labor means prepared products less likely to sell | Chinese restaurants look for prestige items such as lobsters, beef, wine, bottled water | European, Australian chefs outnumber U.S. chefs in high-end establishments |

## II. Road Map for Market Entry

### A. Market Structure

1. Target Population

There are 3.5 million restaurants in China, according to the China Cuisine Association, but the average restaurant has fewer than five employees and sales under $300 per week. Very few of these restaurants can afford or use imported food, and it is important to understand the extreme income splits that underlie the sector and limit the size of the target for imported food.

China has about 810 million rural residents and 460 million urban residents. Urban households spent about Rmb 2460 (USD 296) per capita on food in 2000, while rural households spent only Rmb 1106 (USD 133) per capita.

The Engel coefficient, which measures the percentage of income spent on food, also points to a higher standard of living in the cities. In 2000 rural residents spent 49.1% of their income on food while urban residents spent only 39.2% of a much higher income on food. The lower the coefficient, the more advanced the economy and the more likely residents will have disposable income to spend on dining out. For comparison, Japan’s current Engel coefficient is 23.2, down from 38.7 in 1963.

Even among urban households, residents of just a few coastal areas spend far more than others on dining out. As a practical matter, this cohort – the top 10% of urban consumers – must be the major target for food exporters focused on the HRI sector. The only exceptions are suppliers for foreign-invested fast food restaurants and a few items like chicken paws and fresh fruit. And even these are not truly mass market items.

Shanghai is the most developed market in China, and industry insiders say the average check at a high-end Western-style restaurant is about Rmb 250 (about USD 30), while in Beijing it is only Rmb 160 (less than USD 20). In second tier cities like Hangzhou, the average check plunges to Rmb 70 (USD 8). Sales for foreign-food restaurants in Beijing, Shanghai and Guangzhou totaled USD 202 million in 2001, according to a survey by China Link Research. Even in Shanghai, tens of thousands of office workers lunch at cafeterias that serve a hearty if unappetizing meal for only 3 yuan (less than 40 US cents).

**Figure 6**: Geographical Variations of Disposable Income and Food Expenditure, 2000

| | Per Capita Disposable Income | Per Capita Expenditure on Food | Per Capita Expenditure on Dining Out | % Income Spent on Dining Out | Overall Food Service Revenue* |
|---|---|---|---|---|---|
| All Urban Areas | 756 | 296 | 35 | 4.5 | 4.88 billion |
| All Rural Areas | 271 | 113 | N/A | N/A | N/A |
| Shanghai | 1411 | 472 | 82 | 5.7 | 440 million |
| Beijing | 1247 | 371 | 80 | 6.4 | 533 million |
| Tianjin | 981 | 296 | 49 | 5 | 121 million |
| Guangdong Province | 1176 | 373 | 79 | 6.7 | 1.1 billion |
| Zhejiang Province | 1118 | 332 | 60 | 5.4 | 347 million |
| Tianjin | 981 | 296 | 49 | 5 | 121 million |

Income and Food Expenditure: national, rural, and top-ranked cities, including urban areas of Zhejiang and Guangdong provinces. All figures in U.S.$.

*Restaurants with more than 30 employees or annual revenue above $244,000.
Source: State Statistical Bureau

2. Distribution

Distribution is poorly developed, another factor that hampers market growth for imported or Western-style food outside the coastal region. Although new infrastructure has been built, there is no concept of logistics as an integrated system for moving goods. At least five central government departments administer different logistical sectors, and thousands of localities have their own rules. Goods once shipped are difficult to track. Lack of respect for cold chain procedure makes it unreliable outside coastal cities; dairy products and meat must be shipped to inland locations by air if they are to arrive safely. Moreover, China currently lacks inter-state commerce laws that encourage the free, untaxed flow of goods throughout the country.

Most food distribution companies specialize in one segment of the market, such as dry goods or meat and seafood. Most companies that supply imported products supply little domestic product, and vice versa. No one company offers comprehensive service. (See #2 below.)

Chefs and F&B managers complain that supply is unreliable, with distributors frequently running out of product on short notice. Distributors say this happens because volume for many items is quite low and they try to limit inventory. Late delivery is also common, often related to unexpected delays at customs and quarantine.

Hotels and restaurants therefore find themselves juggling a number of different distributors and purchasing agents to keep supplies flowing. They may source flour direct from a foreign processor with an office in China, meat and seafood from several competing specialist distributors, fruit from another specialist, vegetables from a wet market or a local specialty grower, and dry goods and condiments from still another set of distributors. Some import containers of food products directly from consolidators in the United States. Hotel chains such as Holiday Inn (24 hotels in China), Marriott and Hyatt are trying to develop group purchasing to lower costs. In desperation, individual chefs sometimes ask friends or air crew to hand-carry vital ingredients like Indian spices, caviar or Mexican chilies.

Finding a distributor on the Chinese side who can handle customs and quarantine procedures smoothly is vital. The procedures involve so much paperwork that almost no end-users, including Chinese state-owned companies, try to do it on their own. Some distributors do their paperwork, while others employ agents who specialize in customs and quarantine. Either way can be effective, but arrangements must be made from the Chinese side of the line. Even US consolidators rely on China-based distributors to handle these procedures.

Distribution options for foreign suppliers include:

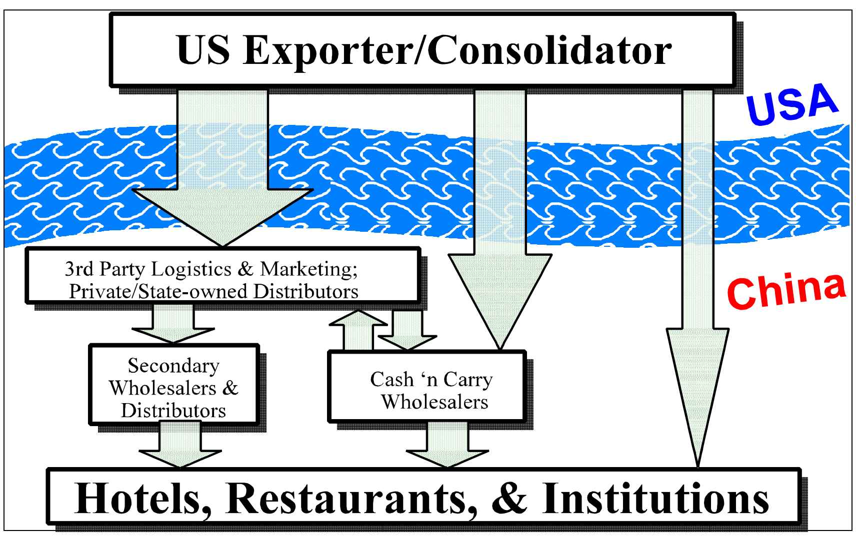
·1 *Small, well-connected state-owned trading companies* spun off from larger institutions like the Ministry of Foreign Trade and Economic Cooperation or the China Overseas Food Import and Export Company. These smaller companies are more aggressive, competitive and cost-effective than their behemoth parents, and some are gradually being privatized.

·2 *Private distributors*, some of them foreign-invested. A few provide full service, vetting the product, consolidating a load, arranging for import and quarantine clearance, warehousing and sales. Others use an import agent to handle the paperwork and other formalities, paying a 1-2% fee. All these distributors work hard to stay close to chefs and to important officials in the customs and quarantine departments.

·3 *Third Party Logistics*. A small group of foreign-managed companies has developed in ports and free trade zones. They offer customs clearance, foreign exchange conversion, bonded warehousing and shipment. These companies cannot however provide any expertise in the food market. Typically the supplier hires a local representative to handle sales and promotion. This route may become more viable as the logistics sector opens up under WTO.

·4 *"Grey channel."* Hong Kong agents who hook up with a distributor on the mainland and import through Guangdong Province, which in effect runs its own tariff and quarantine regime. The product is shipped into Guangdong from Hong Kong, under-invoiced to slash tariffs. Quarantine inspection is swift or non-existent. Although the central government has announced various crackdowns, they don't appear to slow the grey channel down. Perhaps 70% of all imported fresh fruit still enters China this way, along with large quantities of meat, wine, bottled water and other products.

**Figure 7** – HRI Direct Trade Distribution Flow Chart

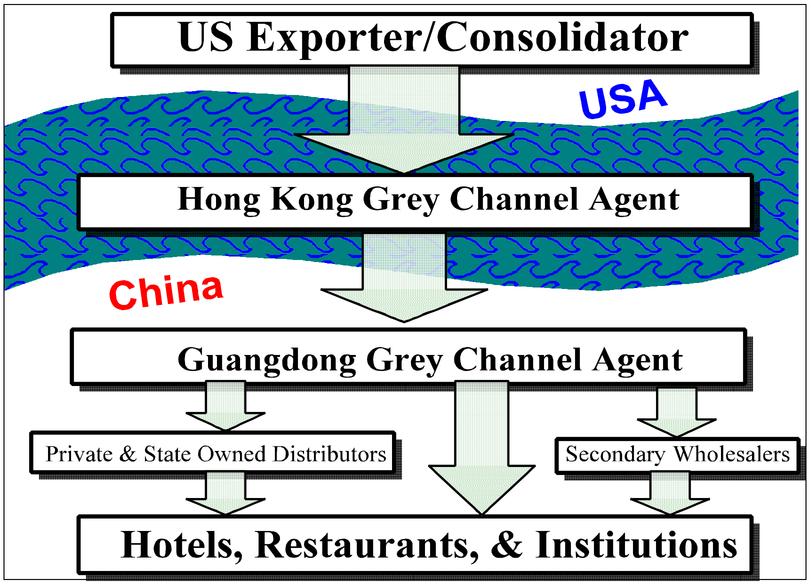


The grey channel is however being affected by the introduction of lower tariffs under WTO rules, which reduce the cost of importing directly to ports in East and North China. Distributors say the cost of paying full tariff and importing direct to Shanghai has already dropped close to the cost of using the grey channel and paying for ground shipment from Guangdong to Shanghai, particularly if reefer transport is needed. Some Cantonese agents in Shanghai have already closed their doors because of this transition. The tariff effect is even stronger in northern China, because of higher in-country shipping costs. Additional tariff drops in 2003 and 2004 should further erode grey channel traffic to Northern and Eastern China.

The channel will likely remain an important alternative for many items not affected by tariff reduction, and also for items that are banned for sanitary or protectionist reasons while demand is still high. For example, although import of US chicken paws was temporarily banned for eight months in 2002, a strong flow continued through the grey channel. The channel is expected to remain the main import channel for South China.

**Figure 7a** – HRI Grey Channel Distribution Flow Chart

·5 *U.S. consolidators* filling direct orders for restaurants and hotels. However, industry insiders say only two or three restaurants or hotels in Shanghai use this method, and it amounts to only a dozen or so containers a year. Suppliers are still faced with the task of persuading a




Shanghai-based chef to order their products.

·6 Distribution via *Western wholesale outlets* like Metro Cash 'n' Carry, a large German-invested price-club hypermarket. This type of outlet is expanding rapidly. It presents a way to reach mid-level restaurants without tailor-made marketing, and avoids dealing with lower levels of the Chinese distribution system. Even high-end restaurants use Metro for some products in Shanghai. However, providing the volume that will persuade Metro to stock your product can be a problem.

·7 *Small individual distributors*. A large number of entrepreneurs have set up small offices and deal in a narrow product line or a few SKUs. Their assets frequently run to no more than an office, a desk and a fax machine. These entrepreneurs seldom understand the market or the product they are trying to sell, and lack the kind of connections with chefs and government officials that larger distributors have.

·8 *Direct sales to end-users*. This rarely happens because hotels and restaurants are reluctant to get involved in obtaining import licenses, permits, inspection certificates and other paperwork. Even hotels that have their own import licenses – including Chinese hotel chains – back off after one or two direct import experiences. One hotel that tried to import a container of specialty bakery products said the cost of complying with all import procedures was actually higher than the goods themselves. They now work only through distributors who have the experience and connections to evade red tape.

Suppliers, distributors and end-users must all deal with complicated government paperwork and procedures, many deliberately designed as non-tariff barriers that increase costs and reduce convenience. For instance, although there is no official quota for meat imports, private distributors say the government retains control of volume through a permit system. The permits specify an import quantity and time limit, and must be renewed periodically.  The USDA periodically publishes FAIRS reports on new Chinese regulations relating to labeling and other topics of interest to American exporters on the Department website.

**B. Entry Strategy**

There's money to be made in Chinese HRI, but penetrating the market and sustaining product sales is hard work. The very first rule, according to suppliers and distributors, is to have realistic expectations. Although there are 1.3 billion people in China, suppliers who think the target is too big to miss risk discovering that the bull's eye for their particular product is very small indeed. The easiest way to lose money is to enter the market without a definite target and a plan.

The second rule is that selling and distributing your product requires fact-to-face contact and, at least initially, hands-on attention to the details of distribution. Because the market is underdeveloped, suppliers need to proceed on two parallel tracks:

- **Marketing:** You will need to introduce your product to both distributors and end-users, and persuade them to use it. Most distributors are relatively small and do not spend a lot of time promoting products, so you need to market directly to executive chefs and others at hotels and restaurants.

- **Distribution:** At the same time, you also have to make sure there is a channel for your product to reach your customers, and a return channel for foreign currency so that you can get paid. There are no easy paths for products to fall in to; a channel has to be built for each product.

1. The Marketing Track

You will need to survey the market, introduce your product to distributors and potential end-users and be prepared to demonstrate and promote it. Make sure you have included all costs in your final price calculations, including tariffs, VAT and transportation.

You can take an initial reading by visiting a food exhibition such as SIAL China or Food & Hotel China. There are a number of these in several different cities every year, where chefs, F&B managers, purchasers and distributors come to check out the latest products from abroad.

Chinese buyers and chefs also frequently visit the United States, often on tours sponsored by the U.S. Agricultural Trade Office (ATO) or state and product associations. And there are usually large Chinese delegations at major U.S. food shows. An additional option is to participate in programs organized by U.S. ATO cooperator organizations, in China and in the United States.

2. The Supply Channel

Your most important relationship in China is with your distributor, so take the time to find one you're comfortable with. A good distributor should be able to coach you on import requirements and be able to handle the burden of import paperwork, either by themselves or through an export agent. They should also have an extensive catalogue, established customers and good relationships with government officials in the import and food quarantine bureaucracies.

Most important, your importer or distributor must be able to make payments in hard currency. The Chinese RMB is a controlled currency that is not freely convertible. Companies need special licenses and permits to change RMB into U.S. dollars. You do not want to find yourself with a pile of RMB that you can't spend outside China, or end up in a barter deal which requires you to export a container of shrimp to collect your money. Many U.S. suppliers require payment in advance.

Among the licenses and permits that may be required are a hygiene certificate from the government of the exporting country, as well as any applicable health-food or biotech certificate; a Chinese import permit, and hygiene and quarantine inspection certificates on entry. The product must also comply with the latest labeling requirements in Chinese. Your distributor should be able to handle all of these issues.

3. Entry Steps

Experienced distributors and food purchasing managers offer the following advice for entering the market:

Ž Have some key target clients in mind before you enter the market. If a hotel, restaurant or air caterer is a client of yours in the United States, try to use that as an entrée to the China branch.

Ž It makes sense to focus on the large international hotels and international food chains as your first clients. These operations have higher volumes than smaller foreign-owned restaurants, and use a far higher percentage of imported products than Chinese restaurants.

Ž Take expansion one step at a time. Master the business among one set of clients and one location before moving on. One of the biggest mistakes you can make is to spread yourself too thin.

Ž The market is immature, and educating decision makers is a key activity. Prepare recipes for your product, especially if you are marketing to a Chinese restaurant; and be prepared to demonstrate them.

Ž Consider bringing a chef or other specialist to give demonstrations and seminars. The United States is known as a source of leading-edge food innovations, and you can take advantage of the credibility this fosters.

Ž Don't overestimate the market. Unless you are supplying one of the fast food chains, only a few products ship large in volumes. Most likely you won't be able to start with full container loads. Small volume shipments also raise costs.

Ž Most U.S. suppliers in the market require payment in advance, although distributors complain that this ties up cash and leaves them holding too much inventory. Easier terms expand volume, but suppliers say the risk of nonpayment is high and contract enforcement weak. It's unwise to give credit unless you have experience with your distributor or you are dealing directly with a foreign hotel or fast food operation.

Ž A number of English-language magazines compete aggressively to cover the Shanghai and Beijing restaurant scenes. They are useful for reference and subdivide the market by national cuisines. High-end Chinese restaurants are also listed.

Ž Face to face meetings with distributors and end-users are important; the best distributors say they refuse to deal with agents because they aren't committed to the market.

Ž Many distributors also service the retail market for imported goods. If your product can also be sold in retail outlets, you may have a better chance of entering the market.

Ž Some suppliers post a salesman at their distributor, or have their own office in-country to handle promotion and coordinate sales.

Ž Try to enter the market with more than one product, so that your whole business won't be nullified by a single adverse government decision.

Ž Look for opportunity in the misfortunes of others. China banned European meat because of problems with hoof-and-mouth disease and BSE. The result has been a boon for U.S. and Australian beef exporters.

Ž Many industry associations, states and even cities have offices in China; many of them cooperate with the U.S. Agricultural Trade Office, which has offices in Shanghai, Beijing and Guangzhou. These can be useful sources of information and tips. They also mount promotional events and festivals. And because they are on the ground, they've developed relationships that can ease your path.

Ž There are many European and Australian chefs in the market, but only a few Americans. Many favor products from their own countries. Taiwanese and Filipino chefs are more likely to be U.S.-oriented. The U.S. government sponsors programs to make sure that Chinese chefs learning Western cuisine are exposed to U.S. products and practices.

Ž Because of China's low labor costs, chefs use fewer prepared and premixed products. Premixed bakery products haven't sold well in the HRI market, for instance, but flour has.

## C. Subsector Profiles

1. Hotel & Resort

The high-end sector is divided between international and domestically managed hotels. Many large foreign chains are represented in the international market, including Hilton, St. Regis, Marriott, Holiday Inn, Shangri-La, Ritz-Carlton, New Otani and Hyatt. Some of these hotel chains are instituting group purchasing for some products.

The Chinese sector is dominated by state-owned companies, but they are rationalizing and the well-managed companies are expanding. U.S. food suppliers should focus on those that run four- and five-star hotels, as few other hotels have Western restaurants, where most imported food appears. Imported prestige or "face" items, including seafood, beef and wine, appear on their Chinese menus. Some have hired Western chefs or management consultants to improve their operations, and are training homegrown chefs in international cuisines. They use state-owned distributors in related companies for most imports, but also occasionally buy from private distributors.

In most hotels, food buying is the product of a negotiation between chefs and the head of the purchasing department, generally a local Chinese. The chef will demand a particular imported item; the purchaser will offer a cheaper substitute**.** In addition, distributors say, food buyers often request fees or kickbacks in return for an order.

According to chefs, a peculiarity of both Chinese and foreign hotels in China is the importance of meat and seafood on the buffet. The buffet accounts for a large percentage of revenue, and Asian diners look askance if there are not a large number of hot meat and seafood dishes. Chefs also note increasing popularity of imported cereals on breakfast buffets, probably because milk consumption is expanding sharply.

**Figure 8** – Largest Hotel Food Sales, 2001

| Company Name | Sales (USD) |
|---|---|
| Shanghai New Asia (Group)* | 144.7 million |
| Jinjiang International Management Group | 86.87 million |
| Tianlun Dynasty Restaurant | 15.7 million |
| Beijing Guibinlou Restaurant Co. | 9.11 million |
| Qingdao Haijing Garden Hotel | 8.96 million |
| Beijing Shunfeng Jinge Hotel* | 7.81 million |
| Beijing Friendship Hotel | 7.71 million |
| Shanghai New Asia Grand Hotel* | 7.69 million |
| Shanghai New Jinjiang Hotel | 6.91 million |
| Shanghai Huating Hotel Co.,Ltd | 6.85 million |

*Includes fast food operation
Source: China Cuisine Association

2. Family-style Restaurants

For purposes of the food supplier, this sector can be divided into high-end Chinese restaurants and foreign restaurants owned and/or managed by foreigners. High-end Chinese restaurants source very few foreign items, with imported food making up at most 5 to 8 percent of sales by value. This consists mostly of prestige items like seafood, beef and wine.

**Figure 9** – Largest Restaurant Chains, 2001

| Company Name | Outlets | Sales (USD) |
|---|---|---|
| Inner Mongolia Xiao Fei Yang Catering Co | N/A | 182.3 million |
| Shenyang Small Potato Catering | 139 | 94.4 million |
| Shanghai Xinghualou Group | N/A | 81.9 million |
| China Beijing Quanjude (Beijing Duck) Group | 46 | 79.9 million |

| | | |
|---|---|---|
| Beijing Dong An Catering Company | 96 | 63.9 million |
| Chongqing Cygnet (Xiao Tian E) Culture | 113 | 58.9 million |
| Beijing Shun Feng Catering & Entertainment | 15 | 56.8 million |
| Guangzhou Jiujia Enterprise Group | N/A | 53.4 million |
| Chengdu Tan Yu Tou Investment Co. | 81 | 53.3 million |
| Chongqing Cai Gen Xiang Feng Su Jiu Lou | N/A | 52.5 million |

Source: China Cuisine Association

The foreign-managed sector is much smaller, but imported products will typically make up 30-40% of food purchases by value, including meat, dairy products, oils, fresh fruit and condiments. Japanese and Korean restaurants are big users of US beef.

3. Fast Food

The fast food market is dominated by foreign chains, with Tricon Global's KFC the largest and McDonald's at No. 2. In 2001, KFC and Pizza Hut together had Rmb 5.4 billion (USD 650 million) in sales; about 10% of KFC's food is imported, and about 20% of Pizza Hut's. These chains import large volumes of potato mix, frozen French fries and cheese, as well as other items like specialty meats, spices, condiments and bakery products.

Chinese fast food companies are also growing, but lack the management systems and food preparation techniques to compete with US outlets. Some say that beyond noodle and dumpling shops, the Chinese menu is hard to standardize. They currently use virtually no imported food products.

**Figure 10** – Largest Fast Food Chains

| Company Name | Outlets | Sales, USD |
|---|---|---|
| Bai Sheng (China) Investment | 660 (KFC, Pizza Hut) | 662 million |
| McDonald's | 510 | n/a |
| Dekeshi Food Development Co. | 200 | 72.3 million |
| Malan Lamian (Pulled noodle) | 382 | 51.8 million |
| *Shanghai New Asia Dabao. | 85 | 23.7 million |
| Lihua Fastfood | 31 | 20.1 million |
| Jiangsu Daniang Dumpling Catering | 50 | 19 million |
| Hainan Longquan Group Co.,Ltd | n/a | 18.1 million |
| Chongqing Catering Services Co., | n/a | 17.8 million |
| Shenzhen Miandianwang Catering | 25 | 15.5 million |

Source: China Cuisine Association

4. Institutional

Institutional food service is widespread, including schools, hospitals, the military and prisons. In the past, most government departments and state-owned enterprises maintained their own canteens, some of them quite large, but many of these are being shut down under reform initiatives. In addition, most Chinese institutions budget less than USD 1 per meal, so little imported food reaches the Chinese side of the market.

A large number of catering companies have sprung up to offer box lunches in cities throughout China, with prices ranging from 5-to-8 RMB (USD 0.60 to USD 1.20) and delivery in 20 minutes. In Beijing and Shanghai these lunches have become more elaborate, with molded trays, clear plastic covers and prices ranging up to RMB 38 (USD 4.60) for a "President's Box." At that price, including a piece of imported fruit becomes possible, but currently these companies don't buy other imported products.

There are, however, some niches that use imported products, chiefly golf clubs, international schools and air caterers, which are among the largest customers for imported meat, dairy, snack food and other products. An industry insider estimates the overall air catering market at RMB 1.6 billion (USD 193 million), with an average 20% of ingredients by value imported.

Distributors also pay close attention to the location and planning of large international conferences, which often create lucrative one-time volume shipments. A tourism conference in Sanya, on Hainan Island, bought almost USD 10,000 worth of U.S. beef in one week. Although not a large amount, that was four times as much as is normally shipped to that tropical resort in a year.

## III. Competition

Local products are the biggest competition for U.S. imports. The Chinese food and agriculture industry is developing almost as quickly as the food service sector, and can increasingly provide import substitutes. Foreign investment is speeding this process, with companies like Hormel, McCormick, and Nestle processing in-country.

Imports that can now be substituted by Chinese products include milk and dairy, fresh vegetables and some juices. An entrepreneur at a small county-owned fish hatchery outside Beijing developed an industry that provides fresh and smoked trout to the Beijing market.

Chefs say they are often faced with deciding whether to use an “A” quality imported item that is twice or even 15 times the price of a “B” quality domestic replacement. Do they really need “A” quality? Menus must frequently be adjusted to what is available rather than what is desired. And chefs confess to mixing “A” and “B” products like flour and even strawberries to raise quality while keeping the price low.

The resident international community has also created import replacements. Expatriates have founded businesses that manufacture fresh pasta, mozzarella cheese, and bagels, and farms that grow fresh produce like sweet onions, endive, white asparagus and all kinds of salad ingredients on a seasonal basis.

International competition is also severe. Suppliers around the world are attracted by the Chinese market, and restaurateurs can pick and choose. European and Australian governments, like the US government, provide support, sponsoring demonstrations, trips and exposition. Distributors report that European companies are particularly aggressive about bringing in chefs to stage demonstrations of their products. They also say that European and Australian companies allow easier payment terms than US companies, many of which require full payment before delivery.

Another “competitor” is China’s huge industry in counterfeit products. One hotel group said that they examine and test imported food far more closely than domestic food, not because they are worried about safety but because they are worried about buying counterfeit product. Beef from other countries is sold as American, as are oranges and other fresh fruit. Sell-by dates are replaced if outdated. These are said to be major problems with the gray channel, where distributors will ask a client, “What label do you want on it?” All this can damage a US brand’s reputation in China.

The following countries were cited by distributors and end-users as competitors for specific products:

Meat – Australia, New Zealand, with Canada and Brazil looking at the market
Seafood – Russia, Japan, Australia, Norway, Canada
Bakery goods – Switzerland, France
Pasta – Italy
Spices – Germany

Fresh fruit – Thailand, Australia, Chile, South Africa
Dried fruit – Australia.
Vegetables (air-shipped) – Australia, Thailand
Cheese and other dairy – New Zealand, Australia, France
Oils, especially olive oil – Italy, Spain
Wine – Chile, France, Australia, Spain, Italy
Bottled water – France
Coffee – Vietnam

## IV. Best Product Prospects

### A. In the Market with Potential

Meat: beef, veal
Chicken cuts, chicken paws
Fresh and frozen seafood
Dairy products (yogurt, butter, cream)
Canned and frozen peas and corn
Flour
Potato products and preparations
Oils, sauces, wine vinegar – olive oil use is increasing for health reasons
Fresh fruit
Frozen berries
Dried fruit and nuts
Premium juices
Condiments (mustard, ketchup, etc.)
Wine – Consumption is skyrocketing
Coffee

### B. Not Present in Significant Quantities, But Good Potential

Fresh lobster
Long-grain rice
Fish head, fish offal
Canned fish
Cooked chicken
Ethnic items such as Mexican food – There has been a craze for Latin restaurants recently in Shanghai
Fast food preparations geared to Chinese cuisine
Venison and other game
Bottled water
Wine
Products that will raise quality when mixed with Chinese products

### C. Products Not Present Because They Face Significant Barriers

Fresh potatoes – Many chefs said they would like a good Idaho potato, but

import is currently forbidden
Sweet onions
Fresh strawberries, blueberries – Not on approved list.

**APPENDIX 1: WTO Tariff Rate Reductions, 2001-2005**

| Commodity | Pre-WTO | 2002 | 2003 | 2004 | 2005 | % Reduction |
|---|---|---|---|---|---|---|
| Beef | 39 | 25.2 | 18.6 | 12 | | 69.2 |
| Beef offal | 19 | 15.2 | 13.6 | 12 | | 36.8 |
| Sausages | 23 | 19 | 17 | 15 | | 34.8 |
| Chicken | 20 | 20 | 20 | 20 | | 0 |
| Chilled Salmon | 14 | 14 | 14 | 14 | | 0 |
| Fish fillet | 27 | 27 | 27 | 27 | | 0 |
| Lobster | 27 | 27 | 27 | 27 | | 0 |
| Fresh grapes | 40 | 23.8 | 18.4 | 13 | | 67.5 |
| Oranges, Lemons | 35 | 22.6 | 16.8 | 11 | | 68.6 |
| Orange juice | 34 | 32 | 31 | 30 | | 11.8 |
| Avocados | 25 | 25 | 25 | 25 | | 0 |
| Frozen berries | 30 | 30 | 30 | 30 | | 0 |
| Raisins | 35 | 22 | 16 | 10 | | 71.4 |
| Potatoes | 13 | 13 | 13 | 13 | | 0 |
| Potato Flour | 27 | 21 | 18 | 15 | | 44.4 |
| Tapioca | 23 | 19 | 17 | 15 | | 34.8 |
| Roasted cereals | 25 | 25 | 25 | 25 | | 0 |
| Powdered milk | 25 | 17.5 | 15 | 12.5 | 10 | 60 |
| Yogurt | 42 | 26 | 18 | 10 | | 76.2 |
| Butter | 44 | 30 | 23.3 | 15 | 10 | 77.3 |
| Cheese | 43 | 27.2 | 19.6 | 12 | | 72.1 |
| Ice cream | 40 | 29.4 | 24.2 | 19 | | 52.5 |
| Lettuce | 15 | 12.4 | 11.2 | 10 | | 33.3 |
| Sweet corn | 13 | 11.2 | 10.6 | 10 | | 23.1 |
| Canned corn | 25 | 16 | 13 | 10 | | 60 |
| Beans | 7.8 | 7.4 | 7.2 | 7 | | 10.3 |
| Pistachios | 30 | 20 | 15 | 10 | | 66.7 |
| Walnuts | 29 | 27 | 26 | 25 | | 13.8 |
| Shelled walnuts | 28 | 24 | 22 | 20 | | 28.6 |
| Canned walnuts | 28 | 24 | 22 | 20 | | 28.6 |
| Coffee | 31 | 23 | 19 | 15 | | 51.6 |
| Instant coffee | 44 | 30.2 | 23.6 | 17 | | 61.4 |
| Pasta | 24 | 20 | 18.3 | 16.7 | 15 | 37.5 |
| Biscuits | 23 | 19 | 17 | 15 | | 34.8 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Jams, nut pastes | 26 | 5 | 5 | 5 | | 80.8 |
| Baking powders | 29 | 27 | 26 | 25 | | 13.8 |
| Ketchup | 27 | 21 | 18 | 15 | | 44.4 |
| Prepared soup | 39 | 27 | 21 | 15 | | 61.5 |
| Mineral water | 45 | 35 | 30 | 25 | 20 | 55.6 |
| Wine | 55 | 34.4 | 24.2 | 14 | | 74.5 |

Source: Ministry of Foreign Trade & Economic Cooperation