a) **Date of Proposal:** February 20, 2008

b) **Name of Organization:** Texas Tech University, in partnership with the Texas Wine Marketing Research Institute

c) **Organization Address:** Box 41240, Lubbock, Texas 79409-1240 USA

d) **Tax Id Number:** 75-600-2622

e) **DUNS number:** #041367053

f) **Primary Contact Person:** Dr. Nataliya Kolyesnikova

g) **Full title of proposal:** Creating New Market Opportunities in China for U.S. Wine Producers.

h) **Target Markets:** China (Mainland)

i) Current conditions in the target market affecting the intended commodity or product:

Background

Recent research has pointed to the changes in the Chinese economy during the last few years. This change has resulted in the involvement of the business community. This boom in the private sector can be illustrated by some simple figures:

- The number of private companies has increased by 35% per year since 1990;
- The private sector represents today 25% of industrial production,
- A third of the GNP (excluding Agriculture) and 11% of employment.
- Currently it is estimated that China has 200 million middle-income consumers (VIA, 2004).

This dynamic environment coupled with the increase in the population's wealth and education should benefit the wine sector. In addition, the wine sector should also benefit from the economic boost provided by the 2008 Olympic Games and the Universal Exposition in Shanghai in 2010.

The Domestic Wine Industry

China's vineyards have expanded 40 percent between 1997 and 2002 and are expected to grow at an annual average of 12 percent through 2007. In 2002, China had about 461,127 acres planted with grapes (VIA, 2004).

Top wine-producing provinces are Hebei and Shandong in North China and Xinjiang in the far west. Although China's wine output has grown rapidly, its exports have declined steadily during the last few years while its domestic consumption has increased (VIA, 2004).

The import duties in China for wines and liquors are respectively 14% and 10%, plus 17% value added tax, applying to imports from most favored nations. There are no import duties for such imports into Hong Kong. However, they are subject to excise tax if these goods are removed for local consumption.

China's demand for wines is growing even faster than its steadily rising production, creating a shortfall that has led to the blending of inexpensive bulk foreign wines with local ones, so most wines labeled as Chinese contained 30-40 percent imported product (VIA, 2004).

However, imports of inexpensive U.S. bulk wines have been undercut by growth in China's own wine production, while lower tariffs and growing disposable income has smoothed the way for bottled wine imports.

Over the past few years, U.S. bulk and bottled wines have followed divergent paths in China. While imports of U.S. bulk wines plummeted between 2000 and 2002, imports of U.S. bottled wines increased 68 percent, according to China customs data. Imports of inexpensive U.S. bulk wines have been undercut by growth in China's own wine production, while lower tariffs and growing disposable income have smoothed the way for bottled wine imports (VIA, 2004).

No single data source completely captures China's market for imported wines. However, certain trends have come to light. In the last several years, China's wine imports have shifted from indirect shipments through Hong Kong to direct shipments into Shanghai, due to improvements in both the quantity and quality of import and distribution options and infrastructure available to U.S. bottled wine producers (VIA, 2004).

Another dramatic change in the Chinese market that also deserves interest is a change in consumer attitude. For example, more Chinese women are drinking wine than before. Recent issues of popular magazines and newspapers have extolled the health benefits of drinking wine. The prospective growth of the market could also be boosted by the reduction in import taxes due to China's joining the WTO as well as by growing market opportunities in cities like Hangzhou, Suzhou, Nanjing, Tianjin, and Dalian, situated in the more developed eastern part of China (VIA, 2004).

j) Description of problem(s), constraints to be addressed, inadequate knowledge of the market, insufficient trade contacts, lack of awareness by foreign officials of U.S. products and business practices, impediments, infrastructure, financing, regulatory or other non-tariff barriers, etc…

The following issues need to be addressed and understand in order for U.S. wine producers to effectively market their products in China. The results of this research study will be published and shared in both academic and trade journals in order to benefit U.S. wine producers, Grape growers and marketing professionals.

Bottle Labeling

China's food labeling law applies to all prepackaged food and beverage products, such as bottled wines. Labels must include: name or brand, net fluid, alcoholic, sugar and other ingredient content, production date, name and address of packer, distributor or importer, must content (expressed juice before and during fermentation), country of origin and quality guarantee or storage period date.

Standard required documents include certificates of origin and health. Bottling companies and wineries often provide certificates of analysis and origin. Many imported wines continue to have original labels on the front of the bottle, with Chinese language stickers on the back. Customs officials are enforcing the labeling law more strictly despite the continuance of imported wine entering without stickers.

Producers are advised to develop Chinese language labels in anticipation of full enforcement of the law. Such labeling will also help to support promotional efforts and to differentiate genuine products from imitations.

Import and Distribution Channels

It is vital for producers to have good relationships with their importers and distributors to ensure that the entire supply process works smoothly. Extensive marketing and educational activities are essential to reach beyond the business traveler and expatriate segments and develop a critical base of Chinese consumers.

Many importers and distributors may not have marketing and education services, so unless new products are competitively priced or introduced through comprehensive educational promotions, they may fail, even in relatively developed coastal markets

Typically, wines enter China's importer and distributor network through three channels:

- CEROILS (China National Cereals, Oils & Foodstuffs Import and Export Corporation), the state monopoly wholesaler and distributor of alcoholic beverages. Most private importers and distributors bring product into the country under the auspices of CEROILS.
- Joint venture and foreign-owned hotels and duty-free stores under China Travel Services. This is a somewhat limited channel, as products are restricted from general distribution.
- The gray channel of Hong Kong and Guangzhou. This channel is declining in importance as duties fall and enforcement of regulations becomes more rigorous.

As the dominant port of entry, Shanghai offers several foreign-run, fully integrated import and distribution options; however, importers in Shanghai are often reluctant to carry new products.

Some importers and distributors offer a full range of sales and marketing services, including climate-controlled warehousing, trade education, market promotion, sales and delivery. Most successful importers and distributors obtain a sublicense from CEROILS, and then handle marketing and distribution themselves - an arrangement that allows them more control over brand development, handling and storage.

Consumer Segmentation

Like many wine drinkers in the West, a fair number of Chinese are not that sophisticated about wine. Much of the culture has not embraced drinking wine with a meal. There's still a tremendous shooter mentality (Levin, 2004).

However, wines did attained consumer acceptance when Chinese politburo member Li Peng decreed that state banquets should be lubricated with wine instead of spirits. The influence of western eating and drinking habits have been a key factor in new cultural trend, as well as rising average incomes in China. Indeed, wine is now becoming the fashionable drink for the wealthy younger generations in China' s cities, and the "badge" drink of China' s wealthiest elite (Levin, 2004; VIA, 2004).

The value of the market has more than doubled over the last five years, and has become much more sophisticated. Not only are there more foreign wine imports available in restaurants and in the shops, but the number, variety and quality of domestic wines has also increased. This has served the market by providing local consumers with a greater array of cheaper products to try.

When foreign wines first entered the Chinese market, they enjoyed a “noble” image due to their unaffordable price for most of Chinese consumers. Now this “status identification” is over and Chinese consumer behavior is becoming more reasonable and personal. Foreign wines are now facing two major obstacles on China’s market: brand unfamiliarity and price uncompetitiveness.

Finally, another change in Chinese culture that will impact wine consumption is the changing home life. Consumers in major metropolitan as areas previously eat three meals a day out of the home, now they are staying at home, primarily due to the rapid expansion of modern apartment construction. People with brand new apartments with nice kitchens and living rooms and entertainment areas. The whole cultural side of China is going to change as people become more affluent (Levin, 2004).

Import Duties and Taxes

When it entered the WTO, the Chinese government promised to decrease the tax on imported bottled wines each year. Under China's World Trade Organization accession agreement, wine tariffs are declining from 24.2 to 14 percent in 2005. If foreign wines can gain market share, consumption taxes may be raised. Since these taxes are assessed on value, they would affect bottled imports more than domestic wines.

Although a lower import tax cannot solve every problem, it will certainly improve the situation of foreign wines in China by helping to reduce the price gap between foreign wines and domestic wines. The price advantage of domestic wine won't be as significant as before.

k) <u>Project objectives:</u>

The project will determine the types and scope of markets for wine; consumer knowledge of wine and wine preferences; domestic Chinese and foreign competition; domestic Chinese production; obstacles faced when importing wines; how to best transport and distribute wine grapes, wine and must; the degree of government's involvement in the markets; the level of technology in wine and wine grape production; and, the role of direct foreign investment under China's evolving market conditions.

Very little is known about the Chinese wine consumer. Who are they? What are there consumption habits? This research project will set in motion a consumer survey in four major Chinese cities, set in different geographical regions of the country. This project will require the cooperation of Texas Tech faculty in the RHIM program with contacts in China, as well as assistance from local graduate students in China.

l) <u>Performance measures: benchmarks for quantifying progress in meeting the objectives</u>

This project has been divided into four stages (see time-line) with detailed comprehensive plans of action. Before implementing the next stage and upon completion of each stage, a through review and evaluation of performance will be performed and adjustments made accordingly.

m) <u>Rationale: explanation for the underlying reasons for the project proposal and its approach, including especially the anticipated benefits:</u>

Currently the U.S. share (22%) of the Chinese wine market is a distant second to France, which can claim nearly 40% of the market and Australia wine has been gaining on the U. S over the past 5 years with a market share now at nearly 20%.

Although imported wines currently maintain the dominant position in the premium wine segment (particularly in top hotels and restaurants), foreign wines are not yet popular in China. Chinese wine consumers are very familiar with domestic brands such as Changyu, Dynasty and Great Wall. However, very few know anything about foreign wines. This makes it difficult for Chinese consumers to distinguish different foreign wines and choose the right one for their purchase.

Texas now is the 5th largest wine producing state in the U.S., with over 130 wineries and xxxx acres of vines under management. Texas wine professionals report the need for increased research on effective marketing strategies targeting new markets that can promote Texas wines. Understanding the Chinese market and their wine consumers may benefit Texas wineries with the possibility of expanding to an international market while it is still developing.

n) <u>Clear demonstration that successful implementation will benefit a particular industry as a whole, not just the applicant:</u>

The Chinese market will live up to expectations only if investment is made in consumer education: the average Chinese consumer knows very little, if anything, about wine, with 90% of the Chinese market dominated by low quality wines. Generally, in wine producing countries consumer wine education campaigns are spearheaded by local producers.

However, Texas Tech University will work in partnership with the Texas Wine Marketing Research Institute to determine who the wine consumers are, their level of wine involvement and knowledge. Dr. Ben Goh and Dr. Nataliya Kolyesnikova of Texas Tech University are the principal investigators.

There are 5 wineries in Texas that account for over 80% of wine and juice production and over 4, 500 wineries in the other 49 states. This collaboration will not only help bring economic value to the Texas wine industry by to improving their wine distribution in the Chinese market, but will add valuable insights for other U.S. wine producers that are in need of expanding into emerging markets and that face competition for larger foreign wine producing countries. Once completed, the results of this study will be shared with other U.S. wine producing and/or grape growers regions and other wine marketing organizations such as the Wine Institute, such that they can establish marketing programs and export programs to penetrate the Chinese market.

o) <u>Explanation as to what specifically could not be accomplished without federal funding assistance and why participating organizations are unlikely to carry out the project without such assistance:</u>

Without federal assistance for an important research project such as this, with potential and significant benefit to U.S. wine producers and grape growers, this project could not be undertaken. This institution has very limited resources available for a project such as this.

p) <u>Specific description of activity/activities to be undertaken:</u>

This study will be conducted using a self-administered paper survey. It is expected that up to 8,000 questionnaires will be handed out to visitors at wine shops, restaurants and major shopping malls; 2,000 in each of the four major Chinese cities. The four major cities are Beijing (pop. 13 million), Shanghai (pop. 20 million), Shenzhen (pop. 10 million), and Guangzhou (pop. 12 million). Data collection will be conducted during May through September, 2008. The survey will be handed to only native Chinese in the four cities, avoiding expatriates that might skew the segmentation results. The participants will be informed that participation is voluntary and that all responses will be kept anonymous and used only for statistical analysis by the research personnel.

Data will also be collected from wine distributors and producers to gather their insights into the production and distribution of domestic wines and the distribution of foreign (imported) wines and their perceived barriers to entry into this market.

The survey(s) will be created in English and then translated into Mandarin Chinese in the U.S. by Chinese graduate students at Texas Tech University and then sent to China (Mainland) to be translated back into English by graduate students affiliated with a hospitality program of a major Chinese university. This technique has been proven successful when dealing with multicultural studies.

Once the data has been gathered, it will be translated back into English. These data will then be screened for missing or unusual entries and entered into an excel worksheet. Once data cleaning and screening is complete, data analysis will be performed using SPSS (14.0) software.

q) Timeline(s) for implementation of activity, including start and end dates:

YEAR:	2008														
MONTH:	APR	MAY				JUNE				JULY				AUG	SEP
WEEK:	1-4	1	2	3	4	1	2	3	4	1	2	3	4	1-4	1-4
PHASE 1: DEVELOPMENT															
Research faculty and graduate student preparation	X														
Develop questionnaires and translate to Chinese	X														
Research survey sites and site selections	X	X													
Research & select Chinese company for professional service agreement	X	X													
PHASE 2: SITE VISIT															
Site visit to survey locations in China			X												
Review intercept survey procedures with professional service agreement agency			X												
Begin survey collection in Beijing			X	X	X										
Begin survey collection in Shanghai			X	X	X										
Begin survey collection in Guangzhou				X	X	X									
Begin survey collection in Shenzhen				X	X	X									
PHASE 3: DATA ANALYSIS															
Clean and screen data for analysis							X	X							
Recruit graduate student analysis for data entry						X	X								
Data Entry									X	X	X				
Prepare initial report for review by research faculty												X	X		
Prepare final report for EMP - USDA														X	X
Publish in academic and industry journals															X

r) Information on whether similar activities are or have previously been funded with USDA sources in target country/countries:

A grant of more than $125,000 has been awarded to the California Association of Wine grape Growers (CAWG). The funds will establish a partnership project to determine Chinese wine fundamentals, which can then be used to develop marketing plans for US wines.

s) Detailed line item activity budget: (budget explanation – next page)

Project Title:	**Creating New Market Opportunities in China for U.S. Wine Producers**			
Budget Period Start	**April 1, 2008**		**Budget Year**	**2008**
Budget Period End:	**September 30, 2008**			
Revision Date:	**February 25, 2008**			
Submitted by:	**Dr. Nataliya Kolyesnikova**		**Budget Totals**	**Matching**

			Budget Totals	Matching
A.	Salary Senior Personnel (Research Associate @ 1.00 FTE for 3 mos.)		$ 19,000.00	$ 18,205.07
B.	Salary Other Personnel			
	Other Professional Staff			
	Other (Unallocated)			
	Language Tutoring			
	Graduate Students			
	Subtotal: Salaries and Wages (A+B)		$ 19,000.00	
C.	Fringe Benefits		$ 5,064.00	$ 4,308.91
D.	Capital Acquisitions (exluded from MTDC)		$ -	
E.	Total Travel		$ 10,476.00	
	Domestic Travel	$ -		
	Foreign Travel (see budget explanation)			
	Airfare for 2 from Lubbock to China (4 cities)	$ 6,000.00		
	3 days hotel in Beijing (sharing room) & Per Diem	$ 1,200.00		
	3 days hotel in Shanghai (sharing room) & Per Diem	$ 1,200.00		
	3 days hotel in Guangzhou (sharing room) & Per Diem	$ 1,026.00		
	3 days hotel in Shenzhen (sharing room) & Per Diem	$ 1,050.00		
F.	Participant Support Costs (exluded from MTDC)			
G.	Other Direct Costs			
	1. Professional Service Agreement (Survey distribution & collection)		$ 16,000.00	
	2. Training Materials		$ 1,500.00	
	3. Sub awards subject to F&A rate			
	4. Sub awards not subject to F&A rate (excluded from MTDC)			
	5. Graduate Tuition and Fees (exluded from MTDC)			
	6. Other Costs, subject to F&A rate			
	7. Other Costs, not subject to F&A rate (exluded from MTDC)			
	Subtotal, Other Direct Costs			
H.	Total Direct Costs		$ 52,040.00	
I.	Modified Total Direct Costs (Total Direct Costs less Capital Acquisitions, participants Costs, Amount of Sub awards>$25k, Graduate Tuition and Fess, and Other, not subject to F&A)		$ 52,040.00	
J.	Facilties and Administrative (F&A) Cost Rate	26%		
K.	F&A Cost Basis Total Direct Costs	$ 52,040.00		
L.	Facilties and Administrative Costs		$ 13,530.40	
M.	**Total Budget Period Costs (Direct + F&A)**		**$ 65,570.40**	**$ 22,513.98**

Budget Explanation:

[redacted]

References:

Levin, D. (2004). Finding a Foothold in the Chinese Market. Wine Business Monthly. Retrieved December 19, 2008 from http://winebusiness.com/?ref=wbm_ln

Vertumne International & Associés (VIA) (2004) The Chinese Wine Market Opportunities and Threats. Retrieved December 20, 2007 http://64.233.167.104/search?q=cache:TgxkTfPomBMJ:www.vitisphere.com/elettre/pdf_fichiers/China_report_2004.pdf+THE+CHINESE+WINE+MARKET&hl=en&ct=clnk&cd=2&gl=us