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Market Brief: Confectionery and Chocolate in China

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Report Highlights:
In 1997 Chinese confectionery manufacturers sold over USD 747 million worth of product. During the same period China imported a further USD 125 million of foreign sugar and chocolate confectionery, but in 1998 these imports shrank by 16% to just under USD 105 million. Influenced by the influx of advanced, high-quality products from abroad, the confectionery industry is rapidly transforming, creating various opportunities for foreign exporters. This report takes a closer look at the overall confectionery market situation in China, the consumption, manufacturing and distribution patterns and trends, the competitive landscape, and some of the existing opportunities in the market.

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SECTION I. MARKET SUMMARY

1. General statistics and main types of confectionery in the market

As of the end of 1997, there were roughly 1,200 enterprises above the township level in China registered with a business license to manufacture confectionery. Their total production output for the same period, according to figures from the China National Food Industry Association, was 595,000 tons of sugar confectionery (including chewing gum) and 40,000 tons of chocolate. According to China’s Statistical Bureau, the total sales revenues of the 798 confectionery manufacturing enterprises with independent accounting in 1997 were RMB 6.2 billion yuan (or roughly USD 747 million). Independent research, though, indicates production numbers are even higher due to the additional output of the difficult-to-account-for township and village enterprises engaged in low-end confectionery production.

Candy manufacturers in China are commonly located within or in the vicinity of large cities, such as Beijing, Shanghai, Tianjin and the major provincial capitals. But overall, there are two traditionally distinct geographic areas in which confectionery production is concentrated. The most prominent confectionery region is Shanghai, with close to 300 enterprises engaged in pastry and sweets production employing over 30,000 people and generating output value of over RMB 4.7 billion yuan (or roughly USD 566 million). Shanghai is also the most developed candy and chocolate consumption market in China, renowned as the home of the oldest Chinese food manufacturing factory, the Guan Sheng Yuan group, originally founded by a private entrepreneur over 80 years ago. This is also where White Rabbit, the best known Chinese brand of candy, is made. The “Made in Shanghai” label for a confectionery product, especially a domestic one, has a brand-name-like importance, almost automatically elevating it to a class above other local products. The other region is Fujian and Guangdong provinces, where cheaper, bulk generic candy, widely found across the countryside market, traditionally comes from. This is also the home of distinguished generic candy makers Xu Fu Ji and Lin Jin Ji. In recent years, newly established joint venture confectionery manufacturing facilities have also been concentrating around the cities of Shenzhen, Beijing, Tianjin, either because of proximity to major markets or to take advantage of government preferential policies offered to foreign invested companies.

The Chinese market bursts with an enormous diversity of confectionery products on display, particularly at the mid- and low-end of the price range. A wholesaler’s booth in an average city or town would normally have a minimum of 20 types of candy displayed. But there are several major types of confectionery, both traditional and recently introduced from abroad, that have come to dominate the market. Below are the most popular types of candy mainly positioned at the mid- and high-end of the market spectrum:

- creamy toffee
- hard (sugar boiled) candy
- soft candy
- chewing gum
- nougat candy
- gummy candy
- lolly pops
- chocolate bars
- chocolate candy
- chocolate wafers
- chocolate-covered nuts
- mints
- jelly candy
- marshmallows

2. China confectionery imports estimate

As with any other commodity in China, it is quite difficult to quote reliable and accurate import statistics for confectionery. Tables 1 and 2 below are based on a consolidation of the Chinese Customs figures and Hong Kong External Trade statistics. Although import duties on confectionery are rather low (15% for sugar confectionery and 12% for chocolate) only a fraction of imported products enter China through legitimate channels. Over 84% of sugar confectionery and 60% of chocolate imports into China enter through Hong Kong, unaccounted for by Chinese Customs. This is particularly true for cheaper no-brand Southeast Asian products as well as higher-end European products with some brand recognition in China. Most leading sources of imported sugar confectionery ship in the vast majority of their products through Hong Kong’s gray channels: Korea - 95%, Malaysia - 88% and France - 80%. Most of the popular European chocolate products come in the same way: Italian - 95%, Swiss - 80%. In contrast, American, Australian and Belgian chocolate importers tend to invest more in their brand name, develop a longer term marketing strategy and bring in most of their products, 84%, 72% and 54% respectively, directly through legitimate channels.

As these latest numbers clearly show, the 1997-98 economic slowdown in China has taken its toll on the domestic confectionery market, with both sugar and chocolate confectionery imports shrinking by more than 15%. Furthermore, the Asian crisis has severely affected Southeast Asian confectionery exports to China. Under such difficult market circumstances, the apparent success of Korean, French and Canadian sugar confectionery, as well as that of American, Belgian and German chocolates, is of even greater significance and suggests a strong long-term potential for these products. Based on this, some experts say that niche markets for high-value, quality imported products are still expanding, despite China’s depressed economy and overall slump in the consumer market.

Table 1: China imports of sugar confectionery (non-chocolate) by country of origin

Rank	Country	1996	1997	1998	1997-98 Change
		(Millions of US Dollars)			(%)
	The World	92.05	96.07	81.39	-15.3%
1	Korea	22.76	32.81	36.95	12.6%
2	Malaysia	15.13	14.77	8.94	-39.5%
3	***United States***	***4.48***	***4.96***	***4.86***	***-2.0%***
4	France	3.99	3.49	3.94	12.9%
5	Indonesia	6.88	4.32	3.68	-14.8%
6	Turkey	4.13	3.75	3.12	-16.8%
7	Thailand	4.95	5.25	2.75	-47.6%
8	Canada	0.09	0.92	2.01	118.5%
9	Hong Kong	8.01	4.52	1.93	-57.3%
10	Japan	2.05	2.90	1.91	-34.1%

Source: The World Trade Atlas, China Edition (China Customs data) and Hong Kong External Trade Data

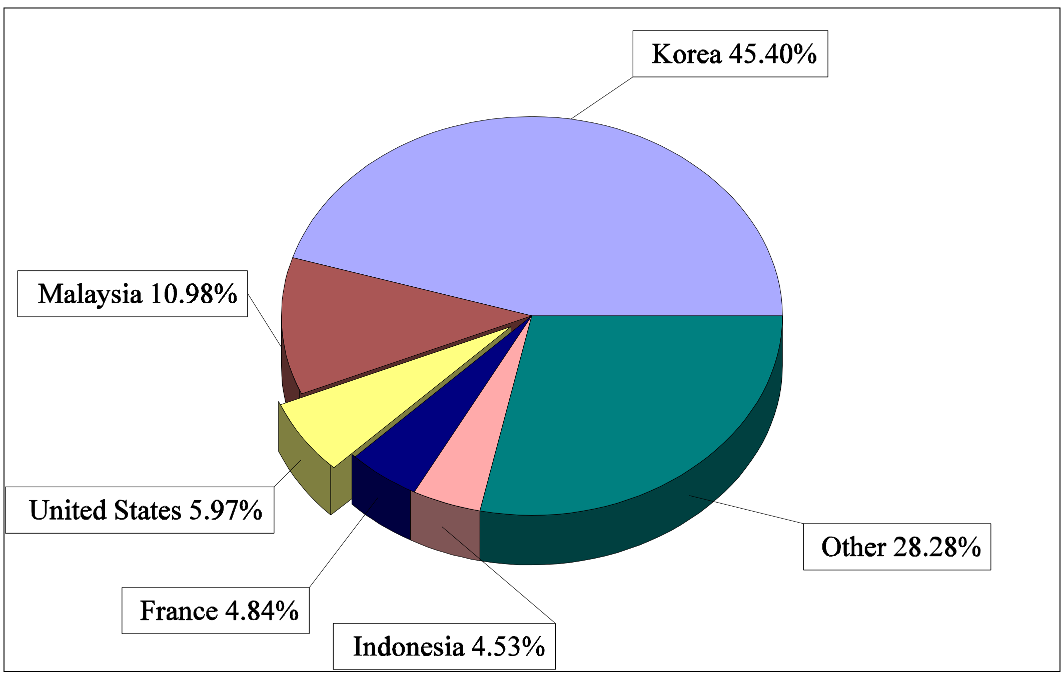

Figure 1: Market share of the top five countries exporting sugar confectionery to China in 1997

Table 2: China imports of chocolate confectionery by country of origin

Rank	Country	1996	1997	1998	1997-98 Change
		(Millions of US Dollars)			(%)
	The World	23.07	29.21	23.50	-19.5%
1	Italy	10.14	12.05	10.26	-14.9%
2	***United States***	***2.94***	***4.58***	***4.88***	***6.6%***
3	Australia	2.37	4.28	2.20	-48.6%
4	Belgium	0.51	0.73	1.64	124.7%
5	Switzerland	2.54	1.87	1.29	-31.0%
6	Germany	0.28	0.38	0.54	42.1%
7	Malaysia	0.79	1.12	0.42	-62.5%
8	New Zealand	0.33	0.26	0.39	50.0%
9	Hong Kong	0.76	0.65	0.36	-44.6%
10	Singapore	0.09	0.66	0.25	-62.1%

Source: The World Trade Atlas, China Edition (China Customs data) and Hong Kong External Trade Data

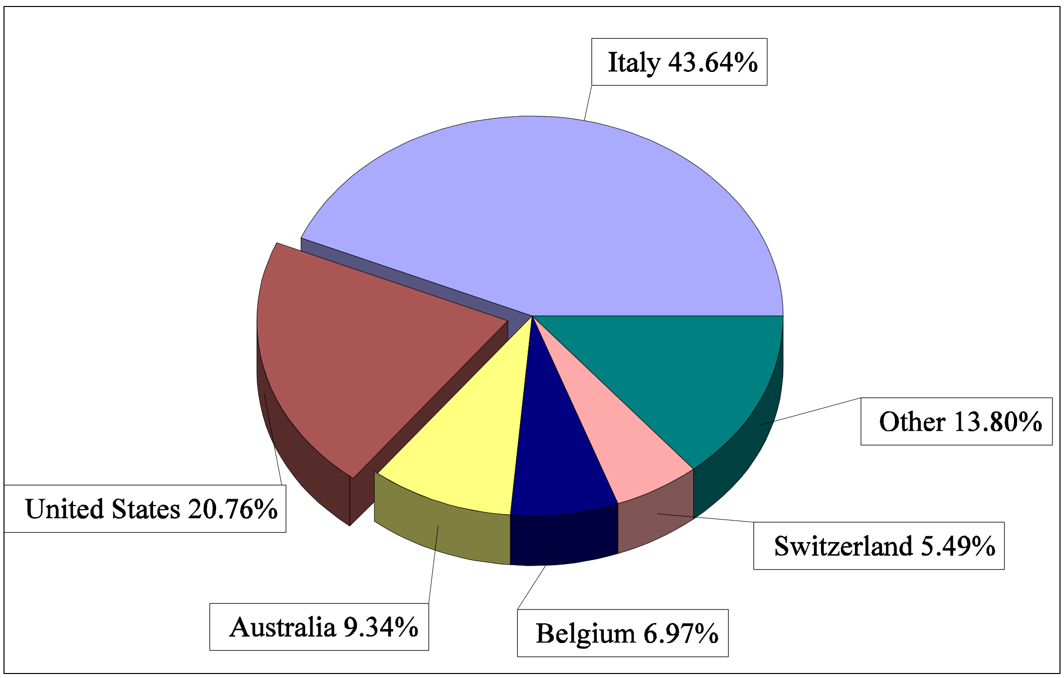

Figure 2: Market share of the top five countries exporting chocolate confectionery to China in 1997

3. Key market drivers in the confectionery industry

Candy is a traditional product in China. For Chinese people it is much more than one section of the food pyramid. Children and young women, who account for the majority of overall candy consumption, are the primary targets of confectionery manufacturers and retailers. New candy products come bundled with toys and other collectibles. In-store displays and POP materials are designed to attract kids, girls and young women. The traditional saying goes: “Girls eat candy and snacks, guys smoke cigarettes and drink alcohol”. This is largely true for the present active adult population of China. But many marketing managers in the confectionery industry are willing to challenge this conventional wisdom. They argue that today’s men grew up with no quality confectionery products to enjoy. That is why these managers are eagerly targeting young boys and girls alike, so that their products may become childhood favorites. And the kids are likely to continue to consume the same brand or flavor when they grow up. One interesting exception to the above rule are menthol drops, the best known brands being Ricola and Fisherman’s Friend, which are identifiably white-collar male products. They have had a consistently stable market in China’s big cities over the past several years.

While similar consumption and market trends can be observed in the snack food sector, candy occupies a special place in Chinese traditional culture. It is a gift item of choice. When Chinese visit family and friends, particularly during holidays like National Day (October 1), Labor Day (May 1), Children’s Day (June 1) or New Year’s Day (January 1), the most common gift they bring for the hosts is candy or chocolates. Traditionally, this was loose toffee or hard candy that ended up on the host’s dinner or tea table. Now with the slow but sure acceptance of chocolate and the technological and marketing advances in the domestic confectionery industry, candy gifts also include a wide variety of products such as chocolate bars and boxes, soft candy, gummy candy, jelly candy and toy packages. According to industry insiders the gift candy sub-sector is growing at notable rates, with more high-end luxury products introduced to and accepted by the market.

During the Chinese lunar calendar New Year, or Spring Festival (usually falling between mid-January and mid-February), this tradition of giving candy as a gift and buying enough to put on every table at home is brought to its annual extreme. The month before Spring Festival is the zenith of the high season for all confectionery manufacturers, and during the several weeks of pre-Chinese-New-Year sales many of them record up to a third of their annual revenues.

Another major driving force in the confectionery industry is the Chinese tradition of giving out candies to all the guests at a wedding. This tradition has practically created a niche sub-sector of the candy industry, the *xi tang* or “happy candy”. Again, historically the *xi tang* was a pocket-size sachet pack containing eight pieces of toffee or hard candy. It is imperative that the principal color of the package is red (some yellow is allowed) and features the auspicious Chinese character for “double happiness” as its central design element. One pack of *xi tang* for each guest is placed on every table during the reception, and packs or pieces are given out to neighbors, relatives, colleagues and friends. This market is still dominated by the old traditional Chinese brands like White Rabbit and WoWo, but has recently been invaded by most joint venture or foreign licensed brands. For example, a Shanghai company producing butterscotch candy under license from the Italian company Perfetti has introduced an original *xi tang* package - a red and yellow paper box with 8 pieces of candy inside. Dove chocolate and Hershey’s have both introduced new *xi tang* products. Overall, *xi tang* is a handy addition to a brand’s product range, offering great exposure, and generating decent supplementary revenues during the two popular wedding months - September and May.

The most recent trend among confectionery consumers is their rising health awareness. Mothers concerned about their children’s dental health are careful not to let them eat too much sugar. Young women increasingly abstain from food products high in calories. This is hurting some of the traditional confectionery producers, but on the other hand, creates an opportunity for quality low-fat, sugar-free foreign products.

4. Confectionery industry SWOT analysis

China’s market for confectionery products has undergone considerable changes in the past decade, mostly influenced by rising living standards and the influx of high-quality products carrying foreign brand names. As a result, the domestic confectionery industry has been transformed dramatically, too. But there are a few characteristics of the market and consumer habits that are distinctive for and unique to China. Below is a simple “SWOT” analysis of the confectionery sector in China:

Strength	**W**eakness	**O**pportunity	**T**hreat
Higher living standards and health education are driving consumers towards better quality and imported confectionery.	The “traditional” sugar candy (toffee, hard fruity handy and soft candy twist-wrapped or pillow-packaged) market has been shrinking by about 30% for 2 years in a row.	Chinese producers have little or no R&D capabilities, so they are slow to introduce new/novelty candy products to the market.	Counterfeit products appear in the marketplace as soon as a branded product is relatively successful.
The market for chocolate and high-quality imported candy has been growing steadily during the period 1992-97.	Chocolate is still considered a “foreign” taste by most Chinese.	Chocolate is capturing the younger, better off Chinese consumers in a significant way, both as a trend and as a new taste.	A number of foreign chocolate brands have entered the market in the past 5 years and most of them have established domestic manufacturing.
Candy is a preferred gift item, traditionally presented at weddings, birthdays and New Year’s celebrations.	The market is distinctively price-driven, both on the wholesaler and consumer level.	Innovative packaging, novelty candy and cross-branding are very scarce and underdeveloped.	Economic slowdown in 1997-98 is affecting the domestic confectionery market.
	Candy is still a distinctly seasonal commodity. The saying goes: “Candy and liquor in the winter, ice cream and beverages in the summer”	High-tech, good quality foreign products, that do not melt in the summer, can capture market share during the traditional low season.	Local producers are already acquiring Japanese and Korean technology for products that have had successful pilot sales in the Chinese market.
	There are too many producers in this very fragmented market. In the smaller cities and countryside, candy is almost a commodity item.	Outside the big cities the market is very under-supplied throughout the year, with a limited variety of quality candy products.	Little brand awareness and loyalty, especially outside the cities, except for the old Chinese brands like White Rabbit.

SECTION II. MARKET STRUCTURE AND TRENDS

1. Distribution channels for confectionery products

The distribution and handling system for domestic confectionery products, particularly the more traditional ones, is well established and varies little from city to city. Below is a simplified flowchart describing the main distribution channels in the confectionery industry.

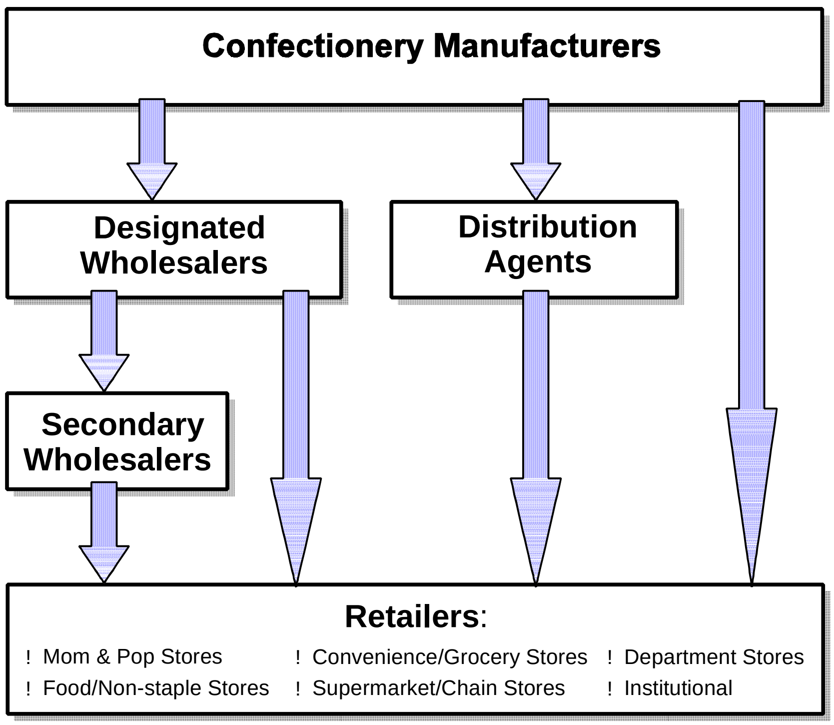

Figure 3: Sales and distribution flowchart for domestic confectionery

Traditionally, confectionery manufacturers are located in close proximity to their major consumer market. Thus, historically, Shanghai had the highest concentration of sugar candy and chocolate producers, but now many joint-venture facilities are being built around Beijing and in Guangdong province. A domestic producer is generally able to handle distribution within his home city and surrounding areas. Most manufacturers, using their own sales force, distribute directly to local retailers, concentrating on the large department stores, food stores and supermarket chains (falling under the A, B or C category of retailers). Only a few confectionery producers distribute to “Mom & Pop” stores (or D stores), which is locally referred to as “direct sales”, or sign up an agent to do it for them.

When a confectionery manufacturer expands his market to a remote city (or one outside his local distribution capability) he normally signs up a distribution agent to cover the entire city market. A *distribution agent* is either a state-owned or privately-controlled company whose main job is to sell, distribute and sometimes market the manufacturer’s products within the retail (and occasionally wholesale) market of one city or region. Most distribution companies require exclusivity for the area they cover. Distribution agents generally work to target the city market and cover the full spectrum of retailers. Most agents are themselves food retailers or have a retail subsidiary. They own or have access to warehouse facilities and keep a rolling stock of their main products. They own their own vehicles and deliver directly to the retailers. Depending on the product's performance and popularity, distributors may pay up-front for stock or may only accept a product on consignment. Sometimes regional agents go on to sign up separate city sub-agencies that operate in the exact same manner as described above.

Large volumes of confectionery products still move through the traditional wholesale markets, heading mainly to the smaller towns and the rural countryside. Foreign brands and imported products are still relatively uncommon in these markets, but their growth potential is considerable. A *designated wholesaler* is generally a private company such as a large successful wholesaler, whose main job is to sell and promote the manufacturer's product at one wholesale market. Manufacturers generally appoint a designated (or primary) wholesaler, either one per city, if the city is a bigger one and its markets cater to different non-overlapping localities, or one per wholesale market. Most smaller cities move all of their consumer goods through a single major wholesale market. The designated wholesaler gets preferential discounts and money incentives based on performance, has limited storage facilities, and rarely owns any delivery vehicles. Sometimes manufacturers rent or buy a stand in the major wholesale markets of their home city and act as their own primary wholesaler, although this is rather uncommon.

In bigger cities, designated wholesalers may sell to some smaller retail shops if they do not overlap with an existing distribution agent. In smaller cities, the designated wholesaler acts as a de facto distribution agent. But the primary wholesalers' major customers are the so-called *secondary wholesalers*. They are relatively small private wholesalers from surrounding towns and villages that buy all their products (food, beverage and consumer goods) from the same city wholesaler. They drive all the way in their own or rented truck and take home a truck-full of different products. For the ones that have not figured out transportation in advance, wholesale markets are encircled with private trucks of all sizes, ready to bargain, load and deliver. Secondary wholesalers generally sell to small local retailers of the Mop & Pop caliber, although sometimes their products go onto tertiary wholesalers in even smaller localities.

The retail price formation formula varies significantly for different products as they move through the above distribution channels. Generally speaking, lower-value bulk confectionery products are modestly marked up by manufacturers and wholesalers and rely on large volumes to achieve profitability, whereas high-value, imported or gift products allow for generous mark-ups at each stage of the distribution chain. In the most common case of successful mid-end local or imported candy, primary wholesalers add roughly 5% mark-up, while designated distributors and secondary wholesalers add in the range of 5-10%. In addition, all manufacturers offer performance-based incentives, in the form of cash or gifts, usually awarded at an annual distributors conference. Such incentives can be as much as another 5% of total annual sales or collections. From there on, as a matter of rule, retail outlets add a 25-30% mark-up on top of their purchasing price, with well-known department stores and some small Mom & Pop stores going as high as 50%. Every supermarket, department store or food store also charges a one-time listing (or slotting) fee for adding a product to one of their categories. For Shanghai, this is in the range of RMB 3,000 to 8,000. In addition, any special merchandising, display or advertising at the store comes at a price generally negotiated on a case by case basis. All successful distributors prefer to work with high-value premium and imported products, since the profit margins are much higher than those of traditional local products. This is, of course, provided that the manufacturer or importer backs them with adequate marketing support to make the product a success in their particular region.

In the case of imported confectionery, product is first handled by the regionally appointed Chinese importer, who is usually only responsible for bringing in the product, clearing customs and other import formalities, labeling it with the hygiene inspection hologram, storing and delivering it. Then a city or regional distribution agent is chosen by the foreign exporter. This agent often also represents an array of domestic confectionery and snack food products. The more active exporters, like Hershey's, establish a local representative office that assumes the responsibility for all marketing support and strategic planning for the imported product. The distribution agents are only responsible for meeting sales and market coverage targets and making timely payments. Once the product is in China, it moves through essentially the same channels as its domestic rivals, so the above described distribution structure generally applies to imported confectionery, too. However, the better-organized companies, like Hershey's, require distributors to maintain strict standards for warehousing, shipping, handling and merchandising. They offer training, provide unified merchandising catalogs, and conduct regular performance audits of their distributors. Most imported products are priced too high or lack the necessary marketing support to effectively penetrate the second-tier cities, towns, and villages, so they only make it to the big city markets. But smaller cities and rural areas are slowly accepting more and more foreign products.

2. Trends and structural patterns in the confectionery distribution system

As a whole, distribution channels in China are underdeveloped, poorly-managed and highly inefficient. Distribution and logistics remain the greatest challenges to manufacturers and importers of food products. Nevertheless, in the past five years distribution channels, and particularly the retail environment, in China have improved substantially. The advent of supermarkets, supermarket-type convenience stores, and lately hyper-marts, has created a retail environment which is cleaner, better organized, more efficient and with dramatically improved capability of handling frozen, chilled and fresh foods. Department stores and traditional non-staple food stores are slowly adjusting and investing more in innovation in order stay competitive. Progress, although at a much slower pace, is seen in the way warehouses and delivery vehicles are being organized, equipped and managed.

As a result of the better retail conditions, purchasing habits are slowly changing, too. Now that product is being handled properly through the improved distribution and retail channel, the seasons for products like chocolate and creamy toffee, traditionally restricted to winter sales only, are getting longer every year.

Furthermore, the increasing number of foreign companies importing or setting up joint ventures to manufacture confectionery products has contributed to the rising level of sophistication and professionalism of product merchandising, marketing support and distribution management.

3. Recommendations for new-to-market confectionery exporters

It would be unwise to assume there is one universal strategy that will ensure the success of any confectionery product in the China market. Different companies and products have succeeded due to different factors driving their market. Despite the seemingly stark uniqueness of each historic case, there are a few similarities in their approach, particularly long-term, and the advice they are willing to give to newcomers.

It pays tremendously to conduct good and thorough market research, including popular acceptance of taste, packaging, concept, and price point, for any new-to-market product in China. It is critical that foreign manufacturers and exporters approach this market with realistic expectations, especially when projecting the size and growth rate of their business in China. It is not a bad idea to go slow, test the performance of each product and realize manageable and sustainable business growth.

Superficially at least, the market always wants more variety in a line of confectionery products. Distributors and wholesalers always urge manufacturers to introduce more flavors and SKU's, since it helps them to spread their risk and offer more choice to customers. But it is important to conduct a sober cost vs. benefit analysis and make sure that new introductions are profitable enough to support and not hurt the performance of the entire product line. It is smart to experiment a lot with products introduced in the marketplace, but ultimately consolidate around the proven winners.

It is perhaps most important to develop a long term strategy and build a brand. Brands are extremely important in China today. Chinese consumers are constantly bombarded with new, innovative, cheaper and different consumer products. They and their families have no particular history of consuming most of these products, and therefore almost no brand or product loyalty. They have to trust their perceptions, which today are largely influenced by the mass media and the art and science of marketing. Building a brand is the only way a company can differentiate its product from the rest and ensure long-term success in this very competitive market. Backing your brand with consistent high quality is a winning formula and the reason why so many relatively expensive foreign products are gaining the upper hand over local ones.

4. Confectionery consumption trends

In many ways, Chinese people remain very traditional in their confectionery consumption habits. Candies are still one of the most common gifts that Chinese people exchange, particularly during traditional holiday seasons. Wedding candy, or *xi tang*, is the inevitable customary fixture of Chinese wedding ceremonies and rituals. Children, young girls and women, who according to industry experts consume over 80% of all candy in China, continue to be the primary marketing targets of confectionery manufacturers and distributors. Historically, candy only came in bulk form and various styles of packaged confectionery have only been introduced to the market in the last 10 years. Bulk candy, which is perceived as cheaper, is still widely sold to retail customers, to the extent that some department stores tear open Hershey's fancy packs and dump the chocolate kisses in the bulk candy bins because it sells even better there.

However, as ordinary Chinese people grow better off, they are becoming more selective and cognizant of quality confectionery products, primarily introduced through imports. Modern foreign packaging and marketing concepts are being applied to lure more Chinese customers. Fancy packages, gift packs and luxury items are widely available in stores and preferred by many customers to cheaper products. Chinese customers strongly believe in the link between brand name and quality, and, once they choose a favorite brand, they are generally very loyal to it. An interesting side effect of this is the modest emergence of cross-branding marketing techniques domestically. Established brands are introducing products outside their traditional range or are being bundled with other brands in a different but related sector.

Rising living standards and the Central Government's one-child policy have resulted in a strong trend towards healthier and more nutritional diets. Mothers are trying to limit the amount of sugar their child consumes, concerned about his or her dental health and overall fitness. They are also trying to secure an adequate intake of vitamins and minerals for the child. This has created a market for a new wave of healthy products in the confectionery sector. Sugar-free candy, vitamin C candy and products with added vitamin A, D and calcium are very popular in the market place.

Perhaps the most significant and clearly noticeable development in Chinese confectionery consumption is the advent of chocolate. This is still happening slowly and on a relatively small scale, and some old habits or customs are in the way of this process. However, the potential is substantial, as illustrated by Tables 3, 4 and 5 below:

Table 3: Annual Consumption of Chocolate

(thousand tons)	1992	1993	1994	1995	1996
China	***13.0***	***16.6***	***23.4***	***23.4***	***34.4***
Hong Kong	9.8	10.1	10.5	10.9	11.3
Japan	190.3	190.0	185.0	189.8	174.7
Korea	35.1	42.3	49.0	58.0	63.5
Taiwan	13.2	13.7	14.1	14.6	14.7
USA	1,241.0	1,274.0	1,281.7	1,379.2	1,409.1

Source: Shanghai Food News Magazine/U.S. DOC Statistics

Table 4: Annual Per Capita Consumption of Chocolate

(kg)	1992	1993	1994	1995	1996
China	***0.01***	***0.01***	***0.02***	***0.02***	***0.03***
Hong Kong	1.70	1.74	1.80	1.86	1.92
Japan	1.53	1.53	1.48	1.44	1.39
Korea	0.08	0.96	1.10	1.29	1.40
Taiwan	0.64	0.65	0.67	0.68	0.68
USA	4.81	4.93	4.90	5.22	5.32

Source: Shanghai Food News Magazine/U.S. DOC Statistics

Table 5: Percentage of Chocolate within Overall Confectionery Consumption

(%)	1992	1993	1994	1995	1996
China	***2.54***	***3.04***	***3.98***	***4.37***	***5.11***
Hong Kong	23.8	24.8	26.3	27.5	29.2
Japan	41.2	41.0	40.3	39.6	38.8
Korea	53.8	57.9	61.4	63.8	65.6
Taiwan	26.2	29.8	30.8	33.7	36.6
USA	49.3	49.8	48.0	48.3	47.2

Source: Shanghai Food News Magazine/U.S. DOC Statistics

China’s chocolate market is still smaller than Japan’s or Korea’s and its per capita consumption of chocolate confectionery is just a tiny fraction of that of Hong Kong or Taiwan. Yet, as the above numbers show, the growth rates are impressive and the room for expansion is enormous. All this makes China an important potential market and an attractive one to foreign chocolate manufacturers .

5. Confectionery manufacturing trends

Over the past five years, foreign confectionery companies have been extensively testing their brands and products in the Chinese market. Initially, all foreign branded candy and chocolate products were imported and distributed by local companies. The more successful and long-term-oriented companies, like Le Conté, Mars, Wrigley's and Nestle, were first to establish local representation and later joint venture or wholly foreign owned production facilities. They were followed by other international brands, such as Cadbury's, Hershey's, Mentos and Chupa Chups. Some of these, like Hershey's and Mentos, are still produced abroad and imported to China, but the overall trend set by the multinational companies interested in capturing a leading market share is to establish production facilities locally. By doing this, they not only eliminate the burden of import duties and formalities, but also take advantage of China's inexpensive skilled labor and the preferential policies offered by the government to foreign invested enterprises. But perhaps most importantly, they are able to build and control their own sales and distribution network, devise and implement their own marketing strategies, and ultimately establish and position their brand in line with their strategic plan for the China market. Manufacturers in China, including joint venture and wholly foreign owned ones, are legally permitted to distribute, wholesale and even retail their own products in China. Imported products, however, may only be brought in and distributed by Chinese agents.

For many foreign confectionery manufacturers, selling to China and developing the Chinese market still seems like a risky and unjustified investment of time and money. A relatively safe way for them to test their products in the market, without affecting their brand name, is to sign a licensing agreement with a local confectionery manufacturer, whereby the foreign company provides the technological know-how, the rights to the brand name and possibly some of the key equipment. Naturally, the biggest risk in this case is that, once the product is successful in the market, the Chinese partner may steal the technology and reproduce the product at a lower price point. Another possible vehicle for the licensing approach is to establish a contractual joint venture enterprise (a.k.a. cooperative joint venture), which will acquire all the rights to technology and intellectual property. Since these joint ventures are protected by the Chinese Joint Venture Law they offer a safer solution for foreign companies to enter in licensing agreements without committing to sizable equity investments.

On the other hand, many of the successful Chinese confectionery makers are actively investing in foreign technology, know-how and machinery to add new, modern and high-tech products under their already well-known and established brands. The influx of foreign imports has put even such famous Chinese brands as White Rabbit and Wo Wo on the defensive, scrambling to innovate their outdated product lines. A recent prominent example is the Wo Wo group introducing their extra-rich creamy toffee with technology and equipment from Japan.

An interesting and relatively unexplored alternative, presenting a very good opportunity for both local brands and foreign exporters, is the creation of private labels for the Chinese market by repackaging and branding of imported bulk confectionery. Enterprising local manufacturers have already been working with Southeast Asian companies (mostly from Korea, Malaysia, Japan and Thailand) for years, bagging their higher-quality products in China (or abroad, but for the China market) under a local Chinese brand name.

An intriguing trend observed among confectionery manufacturers is their shift from volume to variety. Pressured by the competitive market, they are trying to offer more variety of flavors and packaging styles, sacrificing large-volume business. This has also to do with consumption habits, particularly in more traditional areas of China, where people like to buy a little from different kinds of equally-priced candies, making their own "cocktail" to bring home or give as a gift.

6. Company profiles tables

Table 6: "The players" in the non-chocolate sugar confectionery industry

Company	Brand Name	Products	Setup / Profile
Guan Sheng Yuan Food Group Co. (GSY)	White Rabbit	creamy toffee, hard candy, nougat and various	Local group co., biggest local brand, has several J/V's
Shanghai WoWo Food Group Co.	Wo Wo, Jia Jia	creamy toffee and hard candy	Pudong township co., has J/V
Gold Monkey Group Co.	Gold Monkey (JinSiHou)	creamy toffee and hard candy	Local group from Henan
Suzhou Magna Foods Co.	Kopiko	coffee hard candy	Indonesian J/V
Shanghai Perfetti Confectionery Co.	Alpenliebe	butter scotch hard candy	Licensed coop-J/V with Italy
Shanghai Chupa Chups Food Co.	Chupa Chups	lolly pops	J/V with GSY
Shanghai ABC Confectionery Co.	A-Mi (Kitty)	creamy toffee and hard candy	American-born Chinese J/V
Guangdong Xi Zi Lang Group Co.	Xi Zi Lang	jelly bites	local, family-owned
Wrigley's Confectionery Co.	Wrigley's	chewing gum	J/V
PT Van Melle Indonesia Co.	Mentos	mint candy	import
Dongguan Xu Fu Ji Food Co.	Xu Fu Ji	various hard and soft candies	local

Table 7: "The players" in the chocolate confectionery industry

Company	Brand Name	Products	Setup / Profile
Effem Foods (Beijing) Co.	Dove / m&m's	chocolate candies, bars, gift pack and boxes	J/V
Hershey International Co.	Hershey's	chocolate candies and bars	Import, with rep. office in Shanghai
Cadbury Food Co. Beijing	Cadbury	chocolate bars	J/V
Shenzhen Le Conté Foodstuff Co.	Le Conté	chocolate candies and bars	J/V
Tianjin Nestle Co.	Kit Kat	chocolate wafers	J/V
Shanghai Coline Cocoa Products Co.	Cémoi	chocolate candies and bars	J/V
Shanghai Shen Feng Foods Co.	Shen Feng	chocolate candies, bars, gift pack and boxes	Locally controlled J/V, No.1 in Shanghai
FERRERO S.p.A.	Ferrero Rocher	chocolate specialty candy	import
Lindt & Sprüngi (Schweiz) AG	Lindt	chocolate bars and boxes	import

SECTION III. COMPETITION

1. Competitive analysis and market shares

The sugar confectionery and chocolate markets are both extremely competitive. There are numerous players on each level, particularly in the non-chocolate candy sector. The products range from high-value, fancy foreign products to simple, locally-made bulk candies of questionable quality. Experts seem to agree that there are good business opportunities at both extreme ends of the market spectrum. Selling large volumes of cheap candies to the smaller cities and countryside is big business for wholesalers around the country, but this market has so far proven to be well out of reach for foreign companies and their products. The high-value imported or joint venture products, on the other hand, offer good potential and generous incentives for distributors in a market that is growing steadily.

The importance of brands in the confectionery industry is reaffirmed by the their visibly dominant market share. As shown by Table 8 below, more than 50% of the non-chocolate confectionery market is dominated by the top three creamy toffee brands.

Table 8: Top 6 best-selling non-chocolate confectionery brands in China for 1997

Rank	Brand Name	Products	Market Share (%)
1	White Rabbit	creamy toffee, hard candy, nougat	28.60
2	Wo Wo, Jia Jia	creamy toffee, hard candy	20.70
3	Da Da	chewing gum	10.15
4	Wrigley’s	chewing gum	10.08
5	Gold Monkey	creamy toffee, hard candy	5.20
6	Perfetti (Alpenliebe)	butter scotch candy	3.50

Source: China National Food Industry Association

Similarly, the top four best-selling brands of chocolate occupy over 50% of the market.

Table 9: Top 10 best-selling chocolate confectionery brands in China for 1997

Rank	Brand Name	Products	Market Share (%)
1	Dove	chocolate candy and bars	21.25
2	Cadbury	chocolate candy and bars	10.35
3	m&m	chocolate candy	10.08
4	Le Conté	chocolate candy and bars	8.59
5	Jin Sha	chocolate candy gift boxes	6.97
6	Shen Feng	chocolate candy, bars and gift boxes	5.79
7	Dah Chong Children’s Food	chocolate candy and bars	3.08
8	Kit Kat	chocolate wafers	2.72
9	Hershey’s	chocolate candy and bars	1.92
10	Wei Sha	chocolate candy gift boxes	1.80

Source: China National Food Industry Association

2. Imported vs. local confectionery

The past several years have seen tremendous growth in the number of imported foreign confectionery products entering the Chinese market. Rising living standards and quality awareness of ordinary Chinese have allowed candy imports, perceived to be of better quality and value, into the market despite their higher price and limited popularity. Market penetration and effective distribution throughout China still remains an uphill battle for imported confectionery products. Table 10 below offers a simple comparison between local and imported confectionery products.

Table 10: Comparative analysis of imported vs. local confectionery

	Local	**Imported**
Advantages	• CHEAP • widely available • some brand recognition • customer loyalty • manufacturers can distribute and sell directly	• consistent high quality • perceived high value for money • attractive/novel packaging • strong marketing support • trendy • distributors make good margins • high-tech, difficult to counterfeit
Disadvantages	• lower quality, no consistency • few novel products and innovative packaging styles • weak marketing • tiny margins for distributors	• higher price • low brand recognition • no established distribution • unfamiliar or unaccepted taste • must go through local agent to import and distribute

3. U.S. products vs. other foreign products

American confectionery products are not regarded by Chinese customers as any better or worse than those from other foreign countries. In comparison with their European and Southeast Asian counterparts, though, American confectionery exporters have been rather slow to enter and develop the Chinese market. Swiss, Italian and Belgian chocolates, as well as Korean, Japanese and Malaysian sugar candies, are at present better known than American ones. And yet products like Dove, m&m's, Hershey's and Jelly Belly, to name a few, have had great success in the Chinese market, with their products seeing constantly growing consumer acceptance. This leads us to believe there is further opportunity for American confectionery products. Chinese people know and are fascinated with the USA, much more than with any other country. This alone is a strong marketing tool. Furthermore, America has an array of modern high-quality confectionery products, as well as strong brand names, that this market has not yet seen .

SECTION IV. BEST PRODUCT PROSPECTS

1. Best product prospects

While there is no "perfect" confectionery product for this market, many industry experts agree there are certain guidelines one can adhere to in order to identify prospective market winners. Consumption trends in the candy and chocolate industry are relatively short-lived, so innovation and product improvement are major driving forces of success in this market.

Because of the limited research and development (R&D) capabilities of domestic Chinese manufacturers, foreign confectionery companies have a competitive edge in this market with their more advanced, high-tech and innovative products that have been developed and tested abroad over the past few decades. Chinese confectionery consumers are lured by novel and unique flavors, shapes and packages of candy introduced by foreign manufacturers. The downside is that these impulsive market fads only last for several months and local manufacturers are quick to come up with cheap counterfeits as soon as there is evident consumer demand. Nevertheless, American companies, with their superior R&D base, have the opportunity to introduce such advanced, trendy products to the Chinese mass candy market and take advantage of the potentially high volumes of sales this could generate. Naturally, the best products will be the ones that are technologically advanced enough so they are not easily reproduced by Chinese manufacturers.

On the other end of the strategy spectrum is the long-term approach taken by many internationally renowned confectionery brands. Chinese consumers believe in foreign brands and the higher quality standards they stand for. International brand-name confectioners have a good opportunity in a vast, relatively "level-field" market, provided they are willing to adopt a more realistic strategy and be prepared to incur operating losses in the first couple of years. This, according to almost everybody in the industry, is the right approach. However, it involves long-term commitment of considerable resources and major investment in developing the brand and the market demand for it.

Rising living standards of ordinary Chinese people and the resulting health awareness have created a strong market for healthy and nutritious foods. This presents high-tech foreign confectionery products, featuring advanced health and nutrition qualities, with an excellent business opportunity in a large emerging market.

Naturally, in all cases mentioned above, there are a number of particular elements that need special attention in order to plan for success. Pricing is probably the most important one. Price has to be controlled and fairly reasonable at least within the same category of products in the market. This is not to say that cheap products will automatically sell better, but consumers must be convinced they are getting good value for their money. Another important detail worth paying attention to is acceptance of flavors and packaging. Although Chinese consumers are generally open-minded and receptive to new intriguing tastes from abroad, there are certain products that remain unacceptable to their palate or cannot meet their hygiene perceptions. Thorough market research is always worth the effort before investing a lot in marketing and distribution of a new product in the Chinese market.

2. Products that will not do well in the market.

It is probably very unwise to take any expert or amateur opinion on Chinese tastes and consumption habits for granted. A number of myths and popular beliefs of what Chinese people like or dislike have been proven wrong by the market in the past 10 years. Among these are the widely predicted rejection by Chinese consumers of coffee and chocolate as foreign tastes, and yet both are increasingly accepted and their respective markets are growing. It is still useful, however, to have an idea of what qualities or features industry insiders think might make a confectionery product a potential success or failure in the market.

Experts are unanimous that strong sweet taste is definitely “out” for confectionery products. Mothers are more wary of sweets damaging their children’s teeth and young girls are more careful with their sugar intake. Many foreign candies and chocolates are perceived as “too sweet” by local customers. It is important to conduct taste and flavor tests before launching a product in the Chinese market.

Strong bitter flavors, such as those of dark chocolate or licorice, are also having a hard time winning Chinese consumers over. Cinnamon is proving to be a less accepted foreign flavor, too. Chinese seem to prefer pure, milky and fruity flavors.

Some industry insiders believe soft candies in general have a limited future in China. They are perceived to melt and deform easily and are widely regarded to be passe in the marketplace.

While bulk is still a very popular way to sell candy to end users even in the big cities, bulk unwrapped candy is increasingly unpopular. Chinese customers regard candy which is not individually wrapped, even if it is packaged in bags or boxes, to be of lower hygiene standard. Companies should be cautious when launching unwrapped products like gummy bears, jelly beans and others, and be sure to survey a good sample of the target customer population. Successful chocolate makers, such as Dove and Hershey’s, have all introduced bite-size chocolates sold in bulk (i.e. by the gram), but all these products, despite their small size, are either twist-wrapped or pillow-wrapped individually.

Finally, it is strongly advisable that a company should engage in detailed research, using taste test and product design surveys, to determine the probable acceptance by Chinese consumers of a new product, even when merely entering a new city or regional market. Tastes and preferences vary greatly from province to province, along with the purchasing power and patterns of the general population.

SECTION V. CONTACTS

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To access other China-related reports submitted by this office please visit the USDA FAS web site at http://www.fas.usda.gov/ click on Countries, and under Market Reports select Attache Reports. On the search form click on Custom Date, select dates from January 1, 1996 and type in either a known AGR Number of a report or a keyword in the Find Subject field. From the country list below the search form select China, Peoples Republic. Then click on the Submit button.

We also recommend the following related reports prepared by our offices in Shanghai, Beijing or Guangzhou:

- Food Distribution in Shanghai AGR # CH7851
- Food Labeling Law Update AGR # CH7846
- Food and Agricultural Import Regulations and Standards (FAIRS) AGR # CH8034
- Shanghai Consumer Food Purchasing Habits AGR # CH8817
- Dalian Consumer Food Purchasing Habits AGR # CH8816
- Guangdong Supermarket Update AGR # CH8648
- Business Travel in China AGR # CH7814
- “Xi Tang” Market: New Trends AGR # CH7812

For more in-depth information on the environment for doing business in China you can purchase the China Country Commercial Guide, updated annually by the Department of Commerce. Country Commercial Guides are available to U.S. exporters from the National Trade Data Bank's CD-ROM or via the Internet at http://domino.stat-usa.gov Contact STAT-USA at 1-800-STAT-USA for more information. They can also be ordered in hard copy or on a diskette from the National Technical Information Service (NTIS) at 1-800-553-NTIS.