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HRI Food Service Sector

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2007

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Report Highlights:

One of the earliest sectors opened to foreign investment, China's booming Hotel Restaurant and Institutional (HRI) sector emerged from a handful of government-controlled cafeterias and dormitories in the late 1970s. Today, China's HRI revenues are in excess of US \$125 billion. Affluent urban consumers are shaping the industry with demand for healthier, faster, and safer menus; terms like 'organic' and 'free delivery' have entered the lexicon. Emerging City Markets are home to millions of people who are trying wine, pizza, and steak for the very first time. The Beijing Olympics in 2008 will mark yet another milestone for China's HRI sector, as China demonstrates its arrival as a major player on the international stage.

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Part I. Market Summary

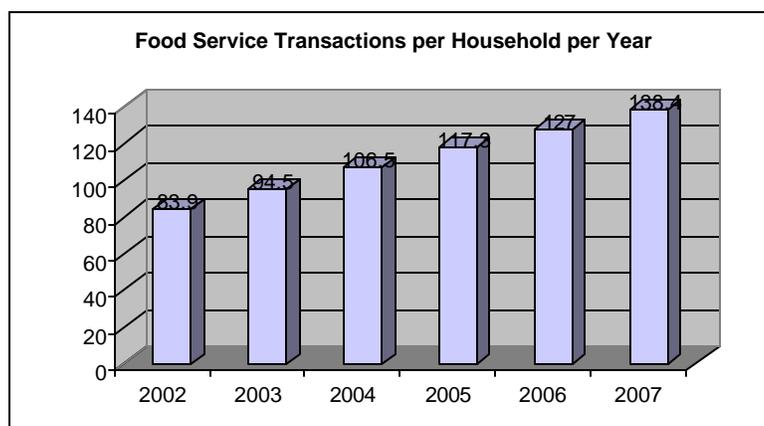
China's domestic HRI sector was liberalized and opened to international investment and domestic privatization as a result of the Reform and Opening policies of the late 1970s, and in the intervening decades, has experienced swift development. International Chinese and expatriate businesspeople flooded to the China market to take part in the 'economic miracle.' Concurrently, international star-rated hotels, world-class restaurants, and quality foodservice for the growing number of professionals working in modern offices evolved. Expatriates, international tourists, government officials on expense accounts and an ever-growing group of wealthy Chinese drove two decades of development in China's considerable HRI sector.

Recent years have seen a significant shift in consumption patterns within China's HRI sector, with wealthy urban Chinese making up the critical consumer base for star-rated hotels, sophisticated restaurants, and food service targeted towards white-collar professionals. China's growing middle class will soon be able to consume at international levels. Annual disposable income increased 30% in the past 3 years, from US \$680 billion in 2003 to US \$966 billion in 2006, and is expected to grow another 5% in 2007 to over US \$1 trillion. The increasing disposable income trend is expected to persist for the next decade, matching China's startling GDP growth, which exceeded 10% in 2006. Per capita GDP was US \$1,477 in 2004, and it is expected to grow to US \$2,275 in 2007, reaching US \$3,558 by 2010.

China's Middle Class

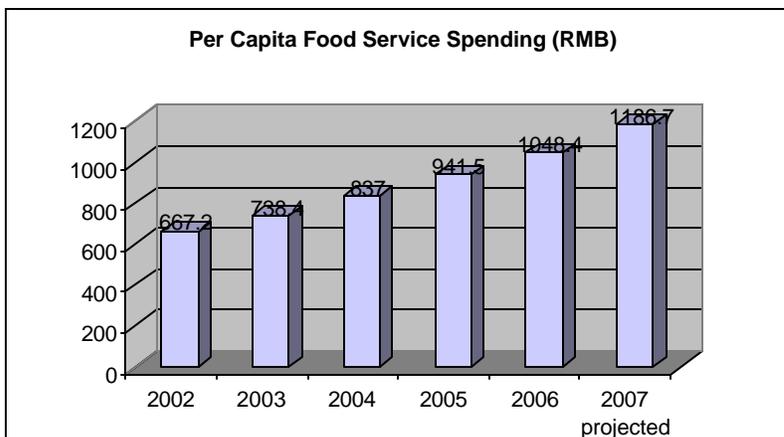
Consumers with the highest disposable incomes tend to be concentrated in Beijing, Shanghai, and cities along Guangdong Province's Pearl River Delta. Adjusted for inflation, Chinese spent 140 times more on dining out in 2005 than in 1975. Each Chinese city has a unique spending personality; in recent years, Shanghai consumers pulled ahead of those in Guangzhou as the leading spenders on food in hotels and restaurants. Nationwide, an average household dines out an estimated 138 times a year, up from only 83 times in 2002.

Shanghai spent three times the national per capita average on dining out in 2005, with restaurant sales reaching RMB 32 billion (US \$4 billion). Guangzhou residents ate out 7 times more often than the national average, spending US \$515.3 annually per capita. Dining out in urban China costs an average of US \$7 more per person per meal, but consumers are ever more time-sensitive, choosing to eat out instead of cooking at home.



As disposable incomes rise, Chinese families increasingly prefer to celebrate holidays and personal milestones by going out to eat at restaurants or hotels. The largest motivating factor is saving the time and energy it takes to prepare large banquets at home. It has become very common for restaurants to promote holiday menus tailored to accommodate family groups of different sizes and budgets. Customers often reserve tables 2 or 3 months in advance for holidays like Lunar New Year Eve and Mid-Autumn Festival.

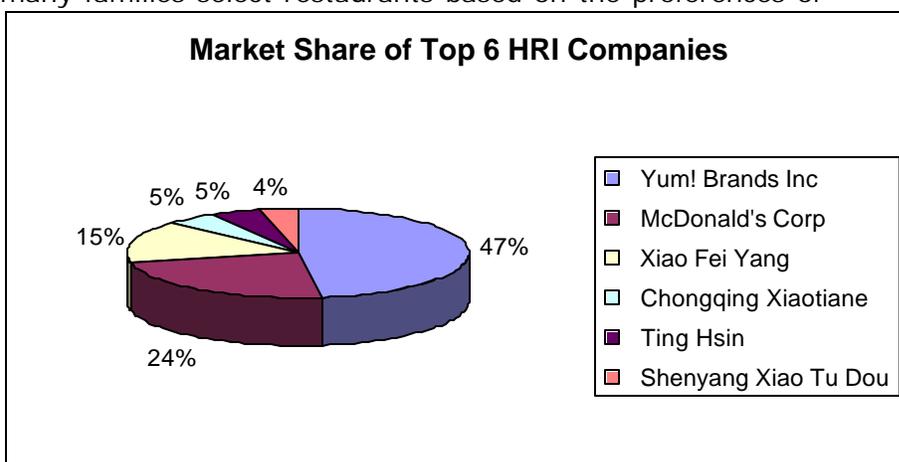
Growth in the catering market has consistently been double-digit over the past 15 years as the sector's retail sales volume climbed 18 percent in 2004 to a value of RMB 888.6 billion (US \$110 billion). Traditionally only hospitals, government offices, and schools were served by institutional food service that is now expanding into high-end office buildings and private entities. Market demand for food service meeting high standards in terms of speed, hygiene, convenience and food quality is on the rise in urban areas. Due to a rapid rise in GDP during 2005, consumer's wallets continued to grow fatter and improved consumer confidence produced marked increases in average consumption in restaurants. Between 2003 and 2006, consumer expenditures on food jumped by 17%. China's catering sector continues to expand and is on the verge of a boom.



Local Culture is King

The strong dominance of local Chinese consumers in the HRI market means cultural factors are playing a major role in consumption patterns. 2006 and 2007 have seen the Chinese zodiac influence high-end dining patterns: The year of 2006 was the 'Year of the Dog', and 2007 is the 'Year of the Pig'. Both of those zodiac signs are considered very auspicious: the dog represents loyalty, and those born during year of the pig are said to get rich easily. As a result, many couples married in 2006, hoping to have children in 2007. This phenomenon has boosted the food service sector and created additional business opportunities. Wedding banquets represent a large market for hotels, restaurants, and caterers.

The one-child policy has also had an influence on how Chinese families dine out: Notorious for spoiling their only children, many families select restaurants based on the preferences of the child. International chained fast food restaurants like McDonald's and KFC have been very successful in capturing this market by developing playgrounds, kid's menus, toys, and birthday celebrations to win the hearts of young customers. Parents are also increasingly conscious of food safety concerns when choosing meals for their children, affecting both fast food and school food service providers.



Banquets and working dinners are critical in Chinese business culture, and represent a large share of the business in China's HRI sector. This is particularly true in Beijing, where businesspeople and government officials often host extravagant dinners on expense accounts. Seeking to impress clients or partners, it is not unheard-of for such customers to spend thousands of dollars at a single sitting – and seek out the highest-end restaurants to

match their budgets. These customers are, as a rule, not price sensitive, since meals are expensed. They demand peaceful, private, comfortable dining environments, high-quality menu items, good selection of beverages, and sufficient as well as private parking space.

Despite the sophisticated cuisine at many traditional Chinese restaurants, shortcomings persist in presentation, nutrition, ingredient quality and combination, and cooking method. Well-heeled Chinese in first-tier cities like Beijing, Shanghai, and Guangzhou seek new and stimulating food experiences. The number of restaurants featuring international and fusion cuisine is on the rise, with an estimated 1,300 restaurants serving international cuisine in Beijing; 1,600 in Shanghai; and over 3,000 in Guangzhou. Affluent white-collar workers, professionals, and expatriate customers increasingly demand ambiance, décor, background music, knowledgeable Waiter staff, exotic aromas along with domestic and imported wine and other beverages in addition to good food – in short, a lifestyle experience.

International Influx

Accession to the WTO has benefited Chinese industries across the board, with gradual removal of market barriers and trade restrictions creating increased competition among domestic and foreign operators. And the thousands of internationals working in and traveling through China continue to have significant influence over the HRI food service market. Demand for high quality food products that meet stringent food safety standards is rising due in part to a large number of expatriates and international Chinese coming to China for business. Official estimates suggest that more than 150,000 foreign passport holders were working in China during 2005, with an additional 140,000 international students formally registered at China's universities. These international customers continue to inspire and influence tastes of the wealthy, as well as erudite and hip young Chinese.

By the year 2020, experts predict that China will be the world's number-one tourist destination, with arrivals of more than 130 million international visitors annually, impressive by any standard. This trend is particularly striking in China's international tourism industry, which only began developing in the late 1970's. Just 20 years later, China welcomed 31 million tourists who spent over US \$16.2 billion. Since 2000, the number of visitors has more than quadrupled, reaching 120.3 million inbound travelers in 2005 alone.

In addition to international visitors, Chinese are increasingly able to travel within their home country: 744 million Chinese traveled domestically in 2000. As China's economy grows, business travel is on the upswing, creating increased demand for travel accommodations. Rising incomes mean that every year, more Chinese join a growing middle class that can afford to travel. Concurrently, the government has boosted leisure travel by loosening travel restrictions and introducing a five-day workweek and substantial vacation time. To encourage tourism, the government has provided nearly US \$100 million to upgrade travel-related infrastructure, including roads, seaports, and airports, as well as to improve tourist sites. As China continues to open, develop, and maintain a strong growth trajectory, living standards have and continue to improve steadily.

Major upcoming events, including Beijing 2008 Olympics and Shanghai World Expo in 2010, have created a favorable environment for the HRI food service sector to expand in China. In addition to the new hotels scheduled to open in 2008, the Olympic Village expects an estimated 17,000 visitors, including a permanent population of over 10,000 residents. Round-the-clock catering service for the Olympic Village and two additional Media Villages will span 30 consecutive days, leading up to, during, and beyond the Olympic games.

B. Sub-Sector Profiles

1. Hotels and Resorts

The World Tourism Organization (WTO) estimates that by 2008 China will exceed Spain as the world's second most popular travel destination, and by 2010 it will be the largest in the world. Despite the appreciation of RMB value in 2006, value of inbound tourism to China increased by 6%, to reach about US \$34 billion. By the end of 2005, China's star-rated hotels totaled to 12,930 – an increase of 2042 hotels, or year-on-year growth of 18.8%. The total number of hotel rooms reached 1.4 million, an increase of over 132,000 rooms or 10.7%. Considering the current investment enthusiasm in China's hotel industry, the number of star-rated hotels is predicted to reach 13,500 by the end of 2006.

The 2008 Beijing Olympics and 2010 Shanghai World Expo are inspiring China's hotel industry to embrace new market opportunities. According to the latest statistics from China's National Tourism Administration, there are more than 13,000 star-rated hotels in China, with a vast expansion underway in business hotels. Vocational training has been in place to bring management service to an international level; increasingly, this training is being strengthened to meet the growing demand for food service industry staff. Most multinational hotel groups continue to use value added products, although executive chefs and purchasing managers are price sensitive. Imported food traditionally makes up 30-50% of the value of the food purchased by internationally managed five-star hotels although this can vary greatly from region to region in a market as large and diverse as China.

Many Chinese hotel chains are still state-owned, but market pressures have forced modernization in management, including the development of efficient and profitable food service operations. However, these hotels have traditionally focused their food service operations on Chinese cuisine, which often depends upon locally grown products and ingredients. As a result, Chinese-managed five-star hotels, both private and state owned, buy far less imported food products than internationally managed hotels, which purchase an average US \$350,000 of imported food annually. These internationally branded hotels cater to a more diverse clientele and provide multiple dining options including international cuisine.

In cities that are major business and tourist destinations, like Beijing, Shanghai, Guangzhou, Suzhou, Hangzhou, Xiamen and Xi'an, all hotels purchase larger volumes of imported food items to satisfy the needs of business and international travelers.

2. Restaurants

China is geographically large and regionally diverse, with very distinct local and regional preferences for flavors and foods. Culinary styles differ widely from city to city in China, necessitating regionally tailored products and marketing. Among domestic consumer foodservice players, there are numerous well-known and distinctive local brands, while there are only a small handful of national brands that provide specialty foods and have been accepted over a long period of growth. Some of these are Xiao Fei Yang, based in Inner Mongolia, and Malan Lamian, headquartered in Beijing. The former is China's number one full-service restaurant, while the latter holds a strong position in the Asian fast food sector. Increasing exposure to and interest in foreign culture in China means consumers are curious to try new western-style foods. It is, however, important to be aware of regional diversity when entering the China market, which is in fact many markets.

A New Dining Lifestyle

Rising consumption and preference for dining options with excellent service and stylish ambience has significantly affected cafés/bars and full service restaurants across China. The number of specialty coffee shops and other cafés is growing rapidly; likewise, popularity of premium restaurants in Beijing, Shanghai, and Guangzhou illustrates consumers' increasing preference for dining options that provide more than just good food. Chained cafés and bars, both international and domestic, have been able to offer the consistency and food quality sought by consumers, leading the dynamic growth of consumer foodservice outlets in China. Starbucks, for example, offers ambience, coffee aroma, and even the soothing background music that contribute to atmosphere. Wireless Internet access and comfortable seating encourage affluent clientele to enjoy a leisurely evening. Among young urban Chinese and expatriates, it is fashionable to meet friends in cafés rather than in fast food outlets or other restaurants. Premium restaurants are another form of lifestyle consumption, as diners enjoy their delicious meals in an exquisite environment that might include designer lighting, an intimate or lavish atmosphere and a high level of personal service.

Annual total gross income rose to RMB 8,960 billion in China in 2005, and is expected to reach RMB 11,657 billion by 2010 – up by around 30%. Emerging middle and upper class consumers, now largely confined to a few major cities, will continue an expansion inland over the next decade. Rising incomes in China have consistently produced interest in restaurants and cafés that offer more than just food and beverage options. Appeal of dining options serving superior food in a stylish setting is increasingly widespread, creating a market for high-quality food products that will continue to expand with China's development.

3. Fast Food

Although fast food is widely perceived as unhealthy by many Chinese consumers, it is likely to experience continued growth in China. Snack foods sold by street vendors have been around for centuries – but in recent decades, long working days without the traditional leisurely lunch break have caused Chinese consumers to turn to fast food. The accelerating pace of life, especially in urban areas, makes consumers more conscious of the time that quick service restaurants (QSR) can save in shopping, cleaning, cooking, and dining.

Following the opening of KFC's first "drive-thru" outlet in Beijing in 2002, a second in Shanghai in 2005, McDonald's announced the debut of its first drive-thru outlet in China in late 2005. McDonald's has also extended its business hours to 24 hours a day in a number of outlets across urban China since 2006. More recently, McDonald's entered into a partnership with Sinopec to open 30 new drive-thru outlets at gas stations nationwide during 2007-2008.

Asian fast food still dominates the market, with its sales value representing approximately 70% of the total in 2005. Malan Lamian and Ajisen are top players, with primary offerings including noodles and dumplings. Taiwan-originated Yong He King, acquired by Jollibee Foods Co. from the Philippines in 2004, sells Chinese-style snacks. Competition among fast food outlets has become increasingly fierce in large cities; leading players are expanding into smaller cities and inland areas. Yong He King expanded into Northwest China in 2005 by opening franchised outlets in Xi'an, the largest city in the Northwest. KFC lowered its franchising fee in order to encourage openings in smaller cities beginning in 2006.

The ability to incorporate local flavor is a key to success for international fast food players. Yum! Brands (managing the successful KFC, Taco Bell, and Pizza Hut chains) officially debuted a Chinese-style fast food outlet in Shanghai in 2005, branded East Dawning. The new brand focuses on serving Chinese- and Asian-style snacks, desserts and dishes. It provides consumers with the distinctive taste of Chinese-style fast food, while also offering a clean and modern feel, and the convenience and speed of service characterized by western

fast food outlets. Capturing multiple consumer groups, such as those who prefer Asian-style fast food, enables Yum! to maintain its leading position in China's fast food environment.

Top 20 Chained Fast Food Brands in China, 2006

<u>Rank</u>	<u>Brand</u>	<u>Company</u>
1	KFC	Yum! Brands Inc
2	McDonald's	McDonald's Corp
3	Dicos	Ting Hsin International Group
4	Ajisen	Ajisen Ramen Chain
5	Café De Coral	Café de Coral Holdings Ltd.
6	Malan Lamian	Malan Lamian Fast Food Chian Co. Ltd.
7	Haagen-Dazs	General Mills Inc
8	Laobian Dumplings	Shenyang Laobian Dumplings Co. Ltd.
9	Mian Dian Wang	Shenzhen Mian Dian Wang Foodservice Co Ltd
10	Yong He King	Jollibee Foods Corp
11	Grand Mother Dumplings	Jiangshu Grand Mother Dumplings
12	Lian Hua	Shanghai Lianhua Supermarket Co Ltd
13	MOS Burger	MOS Food Services Inc
14	New Asia Snack	Shanghai Xinya Dabao Co Ltd
15	Dairy Queen	International Dairy Queen Inc
16	TCBY	TCBY Enterprises Inc
17	Baskin-Robbins	Dunkin' Brands Inc
18	California Beef Noodle King	California Beef Noodle King Co Ltd
19	Yoshinoya	Saison Group, The
20	Beijing Beef Noodle King	Beijing Beef Noodle King Co Ltd

Source: Euromonitor International 2007

4. Institutional Food Service

Modern Chinese culture is increasingly accepting the practice of having corporate, personal, and social events catered. An easy, convenient, and timesaving alternative to self-preparation, this option can often provide better service than a restaurant. Nevertheless, in China, where tradition dictates royal treatment for guests, growth in the high-end catering market has been slow and is still stigmatized by association with lower-end food service options. These perceptions are changing, however, and it should be only a matter of time before high-end catering options are equated with premier quality food service.

In 2005, as much as 40% of HRI revenue came from institutional food service. Working lunches, student meals, catering services for office and factory workers, travelers, exhibitions and event visitors constituted a growing HRI segment. One of the successful local players is Shanghai's Fu Ji Food and Catering Service, listed on the Hong Kong Stock Exchange in 2004 after reporting doubling of revenues in just one year. International companies including Eurest, Sodexo and Gate Gourmet remain strong. These major players will compete to provide food service for the 2008 Beijing Olympic Villages, all of which will be outsourced.

Rough estimates suggest that there are nearly one million domestic catering businesses in China, although many of these are small. In Shanghai, catering companies with annual revenues above US \$10 million continue to emerge. Local surveys indicate 80% of the consumers would like to try catered food or catering services, as long as the food is healthy, prepared according to industry standards, and convenient. As international players enter the Chinese food service market, it is critical that they understand the shortcomings, including

absence of regulations and standards in the current environment, and the lack of transparency in the contracting process and food safety inspections.

C. Regional Market Profiles

Beijing Market Summary

Beijing is the capital of China, a major business hub, and tourist destination. The city's total population reached 15.38 million residents in 2006, 13 million of which live in urban districts. Per capita disposable income exceeded US \$2,500 for the first time in 2006, and municipal government estimates place the city's GDP growth over 11% in 2006, the eighth straight year of double-digit economic growth in the nation's capital.

The conferences, business meetings, and diplomatic events that take place in an international capital city like Beijing set the stage for billions of RMB spent on business lunches, dinners, and banquets each year. Increasing international interest in China and a concentration of must-see historical and World Heritage sights drew more than four million international tourists to Beijing in 2006 – generating total reported revenue of US \$4 billion. Beijing Municipal Tourism Administration further reports that 132 million Chinese visitors from around the country visited the capital, spending an additional US \$20 billion. Economic development and international exposure has translated into an increasingly sophisticated and adventurous clientele frequenting the city's ever-expanding list of diverse and upscale HRI venues.

Beijing also shares close ties with many emerging cities in North China – particularly Tianjin, Qingdao, Shenyang, Dalian, and Harbin. These nearby cities are increasingly affluent major domestic tourist attractions poised for expansion in the HRI sector. Interviews indicate that the distribution networks of international food product distributors have expanded to four and five star hotels across North China. ATO Beijing has developed partnerships with local HRI operators and discovered significant interest in US food products from local media and consumers, particularly when prepared in the 'Chinese Kitchen' style.

Hotels

Swift Expansion

As the 2008 Summer Olympics approach, hotel development has focused on Olympic preparations. Beijing sets a new record for total rooms each year, and has the highest growth in new hotel building of any Asian city. Currently there are 36 projects underway, with 11,288 guestrooms. Seven star-rated hotels were scheduled to open in 2006, with an additional 10 planned in 2007 and 12 in 2008. The newest estimates indicate that Beijing has more than 700 star-rated hotels,

including 253 newly rated properties reviewed in the last year. Review and rating of previously unrated hotels will continue in 2007 in an effort to boost the level of accommodation in the city in time for the Olympics. By 2008, the number of star-rated hotels in Beijing should reach over 800 properties.

2005 Beijing HRI Sector Reviews by Sub-Sector

	Registered Companies	Revenue
Hotel	594	185 trillion RMB
Restaurant	1120	11.7 Billion RMB
Institutional	37	270 Million RMB

Beijing Statistical Yearbook 2006

Star Grade Hotels, Beijing

	2003	2004	2005
5 Star	26	29	35
4 Star	56	62	69
Other	404	473	490
Total	486	564	594

Beijing Statistical Yearbook, 2005, 2006

Big Buyers

ATO interviews with chefs and food and beverage managers at a number of star-rated hotels in Beijing confirmed that imported food products make up a very substantial portion of hotel food budgets. One major 5-star hotel says that imported food products account for more than 50% of their overall food-purchasing budget and estimates that comparable hotels have similar buying patterns. Food ingredients and meat products make up the bulk of the imported foods purchased by these hotels. The St. Regis Hotel, for example, is home to a steakhouse, a coffee shop, an Italian Restaurant, and an outsourced Japanese Restaurant.

Guest Statistics for Beijing's Star Grade Hotels

	2005	% of total	2004	% of total
Domestic	12 mil	78.6%	10 mill	78.2%
Internat'l	2.8 mill	18.4%	2.3 mill	18.7%
Hong Kong	300 thou	1.9%	240 thou	1.9%
Macau	9 thou	0.1%	9 thou	0.1%
Taiwan	170 thou	1.1%	150 thou	1.2%
Total	15.4 mill	100%	12.7 mill	100%

Naturally, the imported products vary widely in each outlet due to differences in cuisine and preparation techniques. As a rule, the steakhouse purchases more imported products than the coffee shop, which only provides buffet-style food.

Beijing Statistical Yearbook 2006

Beijing's star-rated hotels are not particularly price-sensitive customers. During interviews, chefs assured us that delicious, high quality food is a top priority, and price takes a backseat. Hotel food service is particularly focused on creating trendy and attractive menus, incorporating high-quality food products, and emphasizing the nutrition and health benefits of the foods they use. According to one hotel chef, "Imported food, especially American imported food, has good food safety and quality control prior to export, so we are very happy to purchase high quality American food products. We would also like to learn more up-to-date food service trends through media, promotion, and chef training to help us stay on the frontline in continuing to provide premium food service."

Leading Companies and New Markets

The Beijing Olympics represents a critical opportunity for international lodging companies to establish their brands in Beijing and, more widely, in China. Marriott, Starwood, Hyatt, InterContinental, Hilton, Carlson, Accord, Choice and Wyndham are market leaders in Asia, and all have an expanding presence in Beijing. Additionally, Hong Kong-based Shangri-La Hotels is also a major player in Beijing, with 3 five-star hotels and 1 four-star hotel, and an additional five-star hotel scheduled to open in 2008.



Well-appointed dining facilities, Beijing Great Wall Sheraton

Beijing's high-end hotels are ideal for introducing new-to-market foods and cuisines. International branded hotel dining is associated with stylish ambience, convenient location, highly trained chefs and waitstaff, and top-quality ingredients. Hotel dining has expanded beyond resident guests, with well above 50% of diners coming from outside. Well positioned to capture the business entertainment market, hotel dining is also a premium choice for many individuals and families, though hotels

usually charge a 15% service fee.

Restaurants

Beijing has been home to some of China's most sophisticated food culture since the Ming Dynasty when the emperor moved the capital city to Beijing. In addition to the delicate and subtle flavors of Imperial cuisine, world-famous Peking duck and lamb hot pot originated in the city. Now a national capital and international crossroads, Beijing diners savor every flavor of China's regional cuisine, and choose from an expanding range of international options.

From Block House to Outback, from Pizza Hut to Papa Johns, and from the all-American brunch at Grandma's Kitchen to the hip, modern Japanese BBQ at Kagen, the palates of Beijing diners have expanded with their pocketbooks.

Beijing Restaurant Sales (US dollars)			
2002	2003	2004	2005
1.5 bill	1.9 bill	3.3 bill	3.5 bill

Beijing Statistical Yearbook 2006

Beijing's place as a center for top universities, central government agencies, international diplomatic missions and the global business community puts the city on the leading edge of global dining trends. Initially inspired by returned overseas Chinese and expatriates, affluent local Beijingers are now the driving force behind a strong trend for diversity in dining options. Interviews with food service managers reveal that today's Beijing customers are willing to try most anything – particularly those with high disposable income. According to

data from the Beijing Western Food Association, the number of restaurants serving international cuisine is expected to more than double between 2004 and 2008, from over 1,000 to more than 3,000 restaurants. Price increasingly takes a backseat to perceptions of lifestyle; customers expect that the food will be excellent and have turned their attention to service, decoration, ambiance, creative restaurant themes, and so on.



International fare at Beijing's acclaimed Alameda Restaurant

Beijing's size means that, like most metropolitan areas, location plays a large role in restaurants' client base and success. The Central Business District (CBD), stretching across central and eastern Beijing, is home to many of Beijing's best restaurants. Many fashionable new dining destinations opened in the CBD in late 2006, including Jianwai SOHO and The Place, both of which are home to multiple restaurants serving a wide range of international cuisine. Convenience for young and wealthy Chinese professionals and proximity to businesses and embassies likely to expense lunch or dinner make the CDB prime real estate for many high-end dining establishments.

Beijing nightlife continues to be dominated by increasingly sophisticated bars and clubs in the Sanlitun and Houhai areas, catering to wealthy young professionals. Recently, international entertainment giants Heihei (Hong Kong) and Ministry of Sound (London) opened flagship clubs in Beijing, with more global players expected to follow. Beijing's nightlife neighborhoods are filled with high-end 24-hour dining options, many of which have international cuisine on the menu.

Institutional Food Service

Cost-conscious young professionals seeking convenient dining options at this point, largely drive Beijing's institutional food service. As property values rise across Beijing's Central Business District (CBD), 30-story office buildings have replaced local mom-and-pop eateries. Professional staff who don't want to pack a lunch from home are left scrounging for options. Most office buildings over 10 stories have outsourced cafeterias managed by Chinese

companies located in the basement, but quality food products are not readily available, even at the best international office complexes. Cafeteria lunches range from around 10-20 RMB (US \$1.3-2.6), and generally include a number of Chinese-style main and side dishes, rice or bread, and a beverage. While bulk imported food products like flour and oils may find a market here in coming years, the price point of cafeteria food service in Beijing, and China for that matter, still does not accommodate incorporation of high-end menu items.

Higher end institutional food service and catering continues to develop in Beijing, with global brands Sodexo and Eurest taking the lead. There is still space in this market segment, however, and current players are not fully successful at satisfying the increasingly high nutritional, hygiene, price, and efficiency expectations of consumers.

The rise of delivery services brings more players to the institutional and catering market in Beijing. On the lower end, Lihua Fast Food has a surprising and successful business model: they deliver single lunchboxes at a cost of from 8 to 20 RMB. Lihua has no storefronts. Instead, customers place orders by phone, which are relayed to food production centers via Internet. Lunchboxes are delivered by teams armed with maps and GPS within 30 minutes of ordering time or your money back. They have become the largest food delivery company in China, with more than 80 outlets in 11 cities, and are heavily utilized in Beijing. For an increasingly overactive workforce, it is a convenient and relatively inexpensive meal solution.

International brands have recently introduced higher-profile delivery services in Beijing as well. Most internationally known pizza restaurants now offer familiar delivery services – Pizza Hut, Papa Johns, and Domino's all deliver to your door if orders are over a minimum amount. Local and unchained restaurants are beginning to roll out delivery options, with Annie's Italian, Jun Jing Hong Kong Style Restaurant, and many others now just a phone call way.

Olympics 2008

Like a debutante preparing for her coming out ball, Beijing is planning, building, and training at a furious pace for the 2008 Olympic games – less than 18 months away. The Olympics will have an intense short-term effect on the HRI sector, as an estimated one million international athletes and visitors pour into the city, joined by countless domestic spectators. Beijing Tourism Administration expects an additional 100 hotels will be granted star ratings before summer 2008, bringing the total number of star-rated hotels in China's capital to over 800.

As of February 2007, 122 three, four, and five-star hotels have been explicitly designated as 'Olympic hotels,' and an updated list is available on the organizing committee's website, <http://en.beijing2008.cn>. The hundreds of other hotels not officially partnered with the Olympics are also well positioned – our interviews suggest that some hotels are already fully booked, through agreements with international companies and travel agencies.



Beijing's restaurants will also experience a surge in business during the Olympics as millions of Beijing residents, domestic and international visitors will all try to secure meals at the same time. It is predicted many middle-class Chinese in Beijing and across China will dine out in western restaurants for the very first time as they get into the Olympic spirit. Beijing Western Food Association's (BWFA) Secretary General Xu Bin estimates that training will be conducted for more than 10,000 western food chefs in 2007 and 2008. BWFA is organizing a series of food and beverage training sessions in cooperation with Beijing Organizing Committee of the Olympic Games (BOCOG).

Institutional food service is getting in on the Olympic Bonanza as well: catering service for the Olympic Village will run 24-hour service for the 22,000 people expected each day. The Olympic Organizing Committee has adopted western food as the primary menu offering, accounting for up to 70% of the Olympic Village menu. An open bidding is underway, with major international catering companies like Sodexo and Eurest fighting it out for an exclusive contract. In addition, BOCOG has formed partnerships with suppliers like Kerry Oils and Grains (Arawana cooking oil) and Effem Foods (distributor of Snickers brand candy).

Shanghai Market Summary

Shanghai is China's largest city, its leading commercial center and the home of its largest port. With a population of 17.8 million and a 2006 GDP of \$127 billion, per capita GDP reached \$7,131, significantly higher than the rest of China, and 12% higher than the previous year. Shanghai's economy is becoming increasingly focused on finance and services, as rising prices drive manufacturing further a field. International companies continue to find Shanghai attractive, with contracted foreign direct investment of nearly \$15 billion in 2006. Shanghai is an aggressively cosmopolitan city, which derives much of its strong sense of identity from its knowledge and adoption of international brands and fashions. Hence, while Shanghai has a very distinct food culture of its own, the Shanghainese are open to new tastes and new products, making it an excellent market for imported food. As with the rest of China, food plays a central role in all aspects of Shanghai life. Business, networking, celebrations and friendly get-togethers are invariably centered around a meal. Food is widely given as gifts, particularly during festival periods, and this has become an important niche market. Affluent local residents are more than willing to pay for quality products, provided they can be persuaded the product is truly special.

Restaurants

Not surprisingly, Shanghai's robust economy in 2006 and rapid increase in incomes played a major role in boosting the local restaurant industry. According to the Shanghai Restaurant Industry Association (SRIA), the total sales revenue generated by more than 31,400 restaurants reached RMB 45.216 billion in 2006, an increase of 29% over the previous year. Shanghai now tops the list of total restaurant sales revenue in China, surpassing Guangzhou, which had been leading the restaurant industry for decades. Per capita spending on dining out has increased 62.5% from 2002 to 2005. In early 2006, the Department of Commerce projected an increase of 17.6% per capita expenditures on dining out for the year 2006. Given the fact that Shanghai has lead the industry, post would estimate the per capita expenditure on dining out in Shanghai will exceed the average national growth rate and reach RMB 1,597 in 2006.

	Total Industry Sales Revenue		Per Capital Disposable Income	
	RMB (Billion)	Growth Rate (%)	RMB	Growth Rate (%)
2002	18.423	-	13,250	-
2003	21.483	16.6	14,867	12.2
2004	30.017	39.7	16,683	12.2
2005	35.031	16.7	18,645	11.7
2006	45.216	29.1	20,668	10.8

Source: Shanghai Restaurant Industry Association, Shanghai Statistical Year Book 2004, 2006 and www.commerce.sh.cn (a website managed by the Shanghai Economic Committee of Municipal Government)

Shanghai Per Capita Annual Expenditure on Dining Out (RMB)

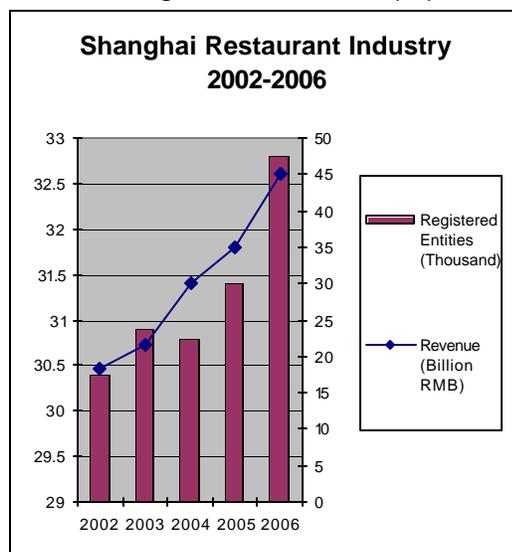
2002	2003	2004	2005	2006
819	897	1,183	1,331	1,597 *

Source: Shanghai Statistical Year Book 2004, 2006

* Note: This is ATO Shanghai's projection for year 2006, up 20% from 2005. Official data was not available when this report was written.

One major characteristic of the Shanghai restaurant industry is the consumption pattern during the holiday and festive season. According to the SRIA, all the major Chinese restaurant groups report a double-digit growth rate during the major Chinese holidays/festivals, such as the traditional Chinese Lunar New Year as well as May 1 and October 1 holidays. Chinese consider the Chinese New Year's Eve dinner the most important meal of the year, as it inculcates family cohesion by providing an opportunity for family members to gather and celebrate the New Year together. As work becomes more hectic, more and more families choose to have their reunion dinner in restaurants. All major Shanghai restaurants are fully booked during this day. Some restaurants even have to impose timings per meal in order to turn the table around as many times as possible that night. The sales revenue for the Chinese Lunar New Year Eve dinner amounted to RMB 763.5 million for 2006. The moon cake, a special delicacy Chinese give as gifts to their friends, business contacts and relatives during the mid-autumn festival generated an additional RMB 1.5 billion in revenues.

All of these Shanghai restaurants become the potential users for high-end imported food ingredients. Some restaurants have already featured imported U.S. ingredients into their recipes to develop innovative products/dishes to appeal to the more adventurous consumers willing to try new products. Thanks to the continuous marketing efforts by USDA cooperators, U.S. food ingredients such as almonds, raisins, cranberries, and prunes etc. are becoming more and more popular as ingredients for the moon cake fillings.



In 2006, wedding ceremony receptions contributed more than 10% to the total industry sales revenue. During the May 1 holiday, a traditional wedding day, 146 restaurants/groups served a total of 36,800 tables. During the October 1 holiday, another big day for weddings, 35,000 tables were served by 138 restaurants/groups. The cost for a wedding reception ranges from RMB 1,000/table to 5,888/table or even higher.

Source: Shanghai Statistical Year Book 2004, 2005 and 2006

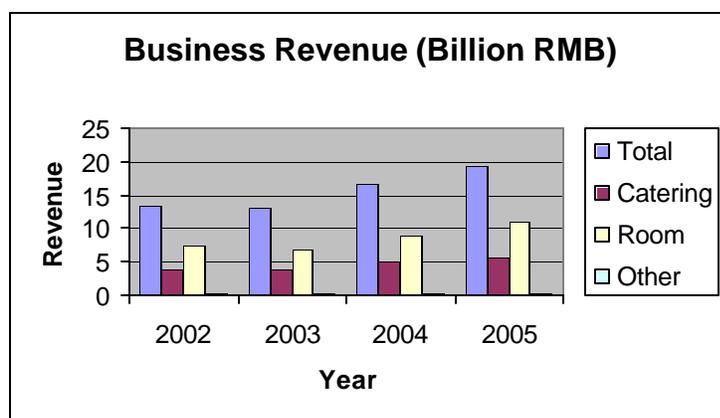
Shanghai's many different types and styles of restaurants provide a wide experience of food entertainment venues, including fine dining, casual dining, Chinese and western fast food restaurants. Unofficial data reveal that there are more than 1,600 western restaurants in Shanghai offering more than 20 different cuisines to the approximate 500,000 expatriates living and working in Shanghai. The increase in disposable income has also led many local Shanghainese to indulge in western food too. High-end restaurants, such as Jean Georges, New Heights and Sens & Bund, scattered around the famous Bund area in Shanghai, are always full despite the steep prices

as high as RMB 300 – 800 per person. To cater to the average consumer, there are also a huge number of western restaurants offering affordable packages at RMB 100 per person. Douniushi, a chain of steak restaurants operated by Taiwanese offering imported US, Australian and New Zealand meats, is gaining popularity among local consumers. Although Douniushi only entered China in 1999, it now has 30 outlets throughout the country.

Trends

The Shanghai restaurant industry is expected to maintain its strong momentum based on the fast growing economic indicators and strong demand for dining out. Furthermore, international venture capitalists have taken a strong interest in privately-owned chain restaurants sparking a phenomenal trend in franchising across China. Shanghai Chamate Food Co., a Chinese food restaurant chain serving tea and light meals, currently has more than 30 stores, and plans to have 80 stores by 2007 and 120 stores in 2008 nationwide. As a result, there will be more chain restaurants in the future where a centralized kitchen and a distribution channel is established to closely monitor costs and quality.

Hotels



Source: *Shanghai Statistics Yearbook 2006*

In 2005, hotel catering revenue reached 5.5 billion RMB (\$688 million), which experts believe was mostly contributed by star-rated hotels. It is the norm in Shanghai for four and five star hotels to allot \$10/person (usually already included in the room tariffs) to the kitchen to enable the chef to include imported food ingredients into the breakfast buffet menu. Judging from the four and five star hotels' average occupancy and room rate (which stood at 72.3% and \$80 (RMB 641), and 68.7%, \$170 (RMB 1,362), respectively, for 2005), breakfast revenue formed a very stable source of revenue. It is therefore not surprising that four and five star hotels remain the core markets for new-to-market and high-end imported food ingredients. Though there is no data available to substantiate our findings on the consumption and demand for domestic and imported food products by the hotel industry, one major imported food distributor supplying hotels in Shanghai reported an annual growth of 20% in its hotel catering business sector for the past three years.

Shanghai's hotel sector is extremely well developed, and continues to expand under the pressure of growing demand. This steady growth can be attributed to the annual influx of more than 75 million domestic and international visitors to Shanghai attending commercial events such as trade shows, conferences, sports events and business trips, an increase of about 18% from the previous year. The Shanghai municipal government has also worked hard to promote the city by working with international organizations to host events, meetings and conferences, and at the same time appeal to individual and group tourists. As

a result, four and five star hotels are routinely fully booked, and during peak seasons there may be no rooms available at this level in the city.

The more than 3,800 hotels that Shanghai currently has can be categorized based on the services that they provide into star-rated hotels or social hotels. While star-rated hotels provide a complete range of premium services from rooms, food and beverages, health clubs to meeting facilities, social hotels only provide the basic minimum accommodation facilities (which depending on locations, may include simple breakfast services).

Shanghai Hotel Industry Statistics 2002-2005				
Year	Total	Five Star	Four Star	Others
2005	351	25	41	285
2004	359	24	37	279
2003	338	20	30	288
2002	319	20	27	272

*Source: Shanghai Statistical Yearbook, 2003, 2004, 2005 and 2006

At the end of 2005, Shanghai had 351 star-rated hotels, of which 66 were rated four stars or higher, an increase of five over the previous year. Expansion is likely to continue or accelerate, particularly in advance of the 2010 Shanghai World Expo. Total business revenues for Shanghai's hotel industry hit a high of 19.4 billion RMB (\$2.5 billion) in 2005, an increase of 17.5% from 2004. Official statistics show that the small number of star-rated hotels, amounting to 351 in 2005, contributed 78% of the total industry's business revenue equaling 15.3 billion RMB (\$2 billion).

Shanghai Star-Rated Hotel (SRH) Statistics 2002 -2005				
Year	Number of SRH	Business Revenues (Billion RMB)	Total Industry Revenues (Billion RMB)	Rate from SRH
2005	351	15.3	19.4	78%
2004	359	14.0	16.6	84%
2003	338	9.7	13.0	74%
2002	319	9.8	13.4	73%

*Source: Shanghai Statistical Yearbook, 2003, 2004, 2005 and 2006

Trends

With the approach of the 2010 Shanghai Expo, Shanghai is witnessing a stream of investments in the construction of both high-end premium hotels and in low-end budget chain inns. It is speculated that around 60 premier hotels will be constructed by 2010 capable of accommodating an additional 3 million guests. The budget chains too have seen tremendous growth since their launch in China a few years ago. At the projected double-digit annual growth rate for the next few years, it is inevitable that more new players will attempt to enter the budget hotel industry.

Catering

Recently, the SRIA formed a Lunch Box Committee to advise its members of the Lunch Box business. This serves only to prove the rising importance of 'lunch box' enterprises that cater to schools, offices and companies, etc. According to the SRIA, based on the calculation of average consumption at RMB 8 (\$1) and 5 million working people taking working-lunch every day in Shanghai, the catering market can be capitalized at around RMB 10 billion. In addition, it is estimated that around 85% of students (approximately 1.4 million people) have their meals provided by schools.

Fuji Food and Catering Services Holdings Limited, established in Suzhou in 1999, is the largest catering company based in the Shanghai area. It reported an increase of 86.4% in its major business—catering, reaching RMB 395.7 million for the first half of its 06/07 year (March - September 2006). Fuji produces 462,500 meal sets every day. A Hong Kong-listed company, Fuji has established a vision to expand its business across China. Fuji will build more centralized kitchens, processing plants and distribution centers to meet the fast growing demand in catering services. It is expected that more and more catering companies will enter this market. This trend will inevitably create a demand for U.S. products, such as meat and seafood products as well as bulk commodities such as soybeans, wheat flour, etc.

Guangzhou Market Summary

Guangdong continues to take the lead in China's economic development, contributing one-eighth to the country's GDP in 2005. Provinces surrounding Guangdong are also developing rapidly, with many newly emerging markets like Xiamen (refer to GAIN report # CH7603), Changsha, Fuzhou, Nanning, Guiyang, Sanya and Guilin.

Guangdong GDP/Disposable Per Capita Income (2001 – 2005)

Year	GDP	Growth Rate	Disposable Per Capita Income	Growth Rate
2001	RMB 1,204 billion (US\$ 155 billion)	10.5%	RMB 10,415 (US\$ 1,344)	7.6%
2002	RMB 1,350 billion (US\$ 174 billion)	12.4%	RMB 11,137 (US\$1,437)	10.6%
2003	RMB 1,584 billion (US\$ 204 billion)	14.8%	RMB 12,380 (US\$ 1,597)	11.2%
2004	RMB 1,886 billion (US\$ 243 billion)	14.8%	RMB 13,628 (US\$1,758)	10.1%
2005	RMB 2,170 billion (US\$280 billion)	12.5%	RMB 14,769.90 (US\$1,906)	8.4%

Source: 2006 Guangdong Statistics Year Book

With more than two decades of development, those living in the Pearl River Delta of Guangdong enjoy one of the highest disposable incomes and tend to dine out more often than Chinese on average. The HRI sector in Guangdong takes the lead in China with total revenues reaching US\$15 billion in 2005. In Guangzhou, per capita expenditure for dining out ranks highest among all cities in Mainland China at US\$533, five times higher than the national average.

With close proximity to Hong Kong and Cantonese love of good cooking, South China is where food trends start. Cantonese were first exposed to western cuisines in the 1980's, when China implemented its "Open Door Policy" which encouraged two-way travel. In addition to local cuisines, the Cantonese are open minded towards trying new products. Imported food products generally enjoy a good reputation for quality among consumers in South China. Concern for health and status influence consumers to buy imported foods.



Fusion food featuring American ingredients

The HRI sector is developing at a two-digit rate in South China. Guangdong recorded a 16.2% increase in 2005 with total revenues at RMB 164 billion (US \$21 billion). Industry sources expect the growth at 15% in coming years.

2001 - 2005 Guangdong HRI Sector Revenues by Sub-sectors							
Year	Hotel	# of co.	Restaurant	# of co.	Institutional	# of co.	Total
2005	RMB 40 billion	7,367	RMB 110.8 billion	120,288	RMB 13 billion	37	RMB 163.8 billion
	US\$ 5.16 billion		US\$ 14.30 billion		US\$ 1.68 billion		US\$ 21.14 billion
2004	RMB 34.5 billion		RMB 95.38 billion		RMB 16.33 billion		
	US\$ 4.45 billion		US\$ 12.31 billion		US\$ 2.11 billion		
2003	RMB 30.47 billion		RMB 89.73 billion		RMB 11.08 billion		
	US\$ 3.93 billion		US\$ 11.58 billion		US\$ 1.43 billion		
2002			RMB 84.38 billion		RMB 10.52 billion		
			US\$ 10.89 billion		US\$ 1.36 billion		
2001			RMB 65.59 billion		RMB 9.85 billion		
			US\$ 8.46 billion		US\$ 1.26 billion		

Source: 2006 Guangdong Statistics Yearbook

Hotels

With more than twenty years rapid economic growth, South China, mainly in the Pearl River Delta, already has most major hotel brands present, including *Marriott*, *Hilton*, *Grand Hyatt*, *Sheraton* and *Inter Continental*. The hotel sector in Guangdong is well established with many newcomers getting into emerging city markets, such as Xiamen, Fuzhou and Sanya.

South China Hotel Industry Revenues

Province	Revenues in 2004	Revenues in 2005	Percentage of change (%)
Guangdong	34.5 billion (US\$ 4.5 billion)	40 billion (US\$ 5.2 billion)	15.9%
Fujian	N/A	4.3 billion (US\$ 556.1 million)	N/A
Hunan	3.7 billion (US\$ 471 million)	4.05 billion (US\$ 522.6 million)	11%
Guangxi	2.3 billion (US\$ 301.9 million)	2.61 billion (US\$ 336.8 million)	11.5%
Hainan	N/A	2.61 billion (US\$ 336.8 million)	N/A
Guizhou	1.1 billion (US\$ 135.5 million)	1.4 billion (US\$ 180.6 million)	33.3%

Source: 2006 Statistics Yearbook of related provinces

The newly opened *Shangri-La* in Guangzhou is the first five-star hotel to open in a decade. Other international brands like the *Ritz Carlton*, *Grand Hyatt*, *Westin* and *Novotel* will open new hotels in Guangzhou within two years. In addition, Guangzhou also has several prominent five-star domestic hotels such as the *White Swan Hotel* and *Garden Hotel*. Increased competition among hotels further pushed local brands to improve management and hotel facilities. The *Garden Hotel* recently finished overall renovation of hotel guest

rooms, and the *White Swan Hotel* is planning to conduct an upgrade project starting late 2007.

2006 South China Hotel Numbers

Province/City	5-star hotels	4-star hotels	Other star rating hotels	Total
Guangdong	41	140	947	3,837
- Guangzhou	6	26	174	1,402
- Shenzhen	10	25	144	501
- Zhuhai	5	9	62	320
- Dongguan	14	22	53	431
- Foshan	1	15	71	120
- Zhongshan	2	4	31	111
Fujian	10	15	70	360
Hunan	8	40	323	388
Guangxi	9	23	318	350
Hainan	13	41	98	364
Guizhou	2	10	165	177

Source: 2006 Statistic Yearbook of related provinces and ATO/GZ survey

Rooms and food and beverages are the main source of revenue for the hotel sector. The average room rate for 5-star hotels in Guangzhou is about US\$100 per night, but prices often triple during the Canton Fair period, held twice a year in late April and late October. As for food and beverage, most of the hotels try to differentiate themselves by emphasizing authentic western taste. Thus, many imported ingredients are used in up-scale hotels. Imported beef, cheese, olive oil, seasoning products and sauces, pasta and seafood products are included in menus.



The *Shangri-La* chain is quickly expanding in the South China market

Western-style restaurants in five-star hotels continue to attract customers who want authentic taste and higher quality foods. Executive chefs at these leading hotel restaurants are well trained and experienced in using imported ingredients. Some of the hotels hire expatriates to serve as executive chefs. ATO/Guangzhou and related cooperators have worked with many of those leading hotel chains on menu promotions and chef activities. Thus, most of the chefs have been exposed to a wide array of U.S. food ingredients. ATO/Guangzhou also identified several key executive chefs to act as market leaders to promote American products in South China's HRI industry. Continuously working with them through menu promotions and chef seminars will ensure they are properly educated on U.S. food products preparation and generate demand for U.S. ingredients.

Restaurants

Although popular throughout major cities in China, dining out has always been a priority for Cantonese people. Famous for its food, Guangzhou is regarded as the "center of delicious cuisines." Different styles of food find their own niches in Guangzhou, and the Cantonese are game to try. Restaurants have to offer innovative new dishes more frequently to keep competitive. Chefs are pushed by the demanding consumer to be more creative in balancing cooking skills with good nutrition to stand out from the competition. Food service suppliers and importers must source new and innovative products to facilitate chefs. Chefs integrate

new food ingredients and different styles of preparation from other regions into traditional Chinese cooking, to create many "fusion" foods.

South China Restaurant Industry Revenues

Province	Revenues in 2004	Revenues in 2005	Percentage of change (%)
Guangdong	99.75 billion (US\$12.9 billion)	110.82 billion (US\$14.3 billion)	11.1%
Fujian	24.12 billion (US\$3.1 billion)	28.68 billion (US\$3.7 billion)	18.9%
Hunan	3.73 billion (US\$481 million)	4.53 billion (US\$585 million)	21.4%
Guangxi	14.43 billion (US\$1.9 billion)	16.57 billion (US\$2.1 billion)	14.8%
Hainan	41.69 billion (US\$5.4 billion)	48.89 billion (US\$6.3 billion)	17.3%
Guizhou	5.86 billion (US\$756 million)	6.47 billion (US\$835 million)	10.4%

Source: 2006 Statistics Yearbook of related provinces

With increasing awareness of food safety, consumers are more than willing to pay a premium to eat food prepared with "green/organic" and nutritional ingredients. To meet this growing demand for healthier, natural foods, more and more restaurants are offering dishes using natural and better quality ingredients. Some American products are highly appreciated by Cantonese consumers because of health benefits i.e., Wisconsin ginseng and California almonds. One of the most popular nutritional soups in South China is Wisconsin ginseng stew with chicken, which is being featured in a number of restaurants due to ATO/*Guangzhou* and *Ginseng Board of Wisconsin* initiatives.

Western-style restaurants are developing quickly in South China. Leading western style restaurant chains like the *Greenery Café* and *Green Island*, which is owned and managed locally, serve a combination of Chinese, Southeast Asian and western-style foods. Local owners run all of these chains; thus, recipes are adjusted to suit local palates. Some U.S. origin food products are used in these chain restaurants, including pork, poultry, Alaskan seafood and seasoning products. With the numbers of expatriates increasingly living and/or working in South China, more authentic western-style restaurants are emerging.



KFC adapted to local culture with Chinese New Year theme advertisement

Western fast food giants like *McDonalds* and *KFC* are expanding their business in South China. Sales revenues of these two chains in Guangdong are the highest in China. New ethnic food styles are introduced to local consumers at restaurants like *Taco Bell*, which serves Mexican food. With more cars on the road, *McDonalds* opened the very first drive-through restaurant in South China and continues to open more. About half of all French fries used by these fast food chains are imported from the U.S. These chains also utilize corn on the cob and poultry products of U.S. origin, mainly wings.

In addition to new *McDonalds* and *Kentucky Fried Chicken* outlets, new international chains such as *Starbucks*, *Taco Bell*, *Pizza Hut*, *Papa John's Pizza*, *Subway*, and *Dairy Queen* are entering the market place.

These restaurants have been extremely successful and often play a major role in introducing Chinese consumers to western cuisine and utilize many imported ingredients in their dishes. For example, cheese consumption is expected to increase rapidly due to acceptance of pizza and other Italian style foods.

Local fast food chains also strive to increase market share. The emphasis on local fast food chains is more with steamed foods or noodles that they claim to be much healthier than fried products. *Zheng Gongfu*, a new Chinese-style fast food chain based in South China, promotes steamed meals and is the first Chinese style fast food chain to have more than 100 outlets in China. Chinese fast food chains tend to use very limited quantities of imported food products because of lower budgets (usually around US \$2 for each meal.)

Educating executives from the HRI sector to properly handle and use imported food ingredients continues to be a main challenge for U.S. exporters. Education concerning unique characteristics of U.S. food ingredients will help Chinese chefs to better understand the proper use of these products and how they can further add value to the menu. The rapid development in the HRI sector has already suffered growing pains from the shortage of experienced and trained personnel, like chefs. One effective way to solve the personnel shortage is to provide proper training to chefs.

ATO/GZ regularly organizes chef seminars and chef competitions in major cities in South China, with support from various U.S. producer associations. In addition to introducing new products, these seminars always emphasize proper handling and preparation techniques. They also create an opportunity for local chefs to get together and discuss different ways to incorporate imported products into their menus. These activities are always well attended and help local industries better understand the characteristics and benefits of using U.S. food ingredients. Many U.S. products introduced to local chefs during these seminars have been widely adopted as a result of these programs.



A recent "Great American Food" promotion organized by ATO/GZ and cooperators in Shenzhen



Fine wines from California displayed at a wine tasting organized by ATO/GZ

Chefs in South China are also very curious about U.S. ingredients and western cooking methods. They are open to enhancing their cooking skills and differentiating their restaurants from competitors. Trade missions to the U.S. always help participants better understand strict production standards and benefits of using American ingredients. Developing loyalty to U.S. products will help create more use of high-value U.S. ingredients in targeted restaurants.

Consumption of red wine is growing steadily in South China for health and status reasons. Thus, middle-to-high-priced (US \$20 per bottle retail price up) imported wine find their market niche in this market. Many upscale restaurants and hotels have a comprehensive wine collection from around the world and state-of-the-art wine cellars. French, Italy and Australian wines are popular owing to steady promotions like wine tasting, wine dinner and wine bazaars. However, American wines are keeping a low profile because of much less promotional activities. Given the good prospect that the South China market demonstrates, several major wine

importers like *ASC*, *SummerGate* and *Montrose* promote imported wines with support from vineyards. U.S. wineries should consider more assertive joint promotion with those importers to obtain and maintain a foothold into the market. Follow-up educational events, like wine tasting, are vital to hold customer attention.

Institutional Food Service

Similar to other foodservice markets in China, the catering industry in South China mainly focuses on providing lunch box types of food, usually ranging from US \$1 to US \$2 per unit. The low price places the imported products in a difficult position to compete with local products. However, we do notice that some local catering chains are expanding and target more well-heeled customers. One of the selling points used by these catering chains is reliable quality, which suits the consumers' desire for food safety. The trend towards safety provides good opportunities for suitable U.S. food products. The higher budget of those meals - usually around US \$3 to US \$4 per set - allows catering companies to consider using imports, like poultry, cheese and potato products.

The expatriate community also creates demand for high quality and western style catering service. To accommodate the growth of expatriates living in the region, more international schools have been set up. Parents of children at these schools expect safe, high-quality meals that include a variety of western-style dishes for their kids. This has helped give imported foods a wedge in the market.

Off-site catering is getting popular in South China. Most five-star hotels and high-end restaurants now offer offsite catering service and reported a steady increase in sales last year. *Guangzhou Restaurant*, a famous chain serving Cantonese-style cuisine, provides both offsite catering and a whole range of prepared dishes for take out. In addition to catering special events, the holiday season creates a strong demand for such services. Usually dishes will include some expensive ingredients, like lobster, prawns and scallops, due to higher budgets for offsite catering. Using imported ingredients adds additional value to the dishes and provides another outlet for imported food products.

D. SWOT Analysis for US Food Products

Strengths & Opportunities	Weaknesses and Threats
Rising incomes mean more people want, and can afford imported food	High price of imported products limits market to high-end urban restaurants
Popularity of US culture extends to food, US fast food leads in introducing Western food	Competition from Japan, Europe, Australia, Southeast Asia and other nations
US has reputation for consistent high quality, health, hygiene, and reliable supply	European, Australian-trained chefs outnumber US-trained chefs in high-end establishments
Strong US brands in a low brand environment	Poor protection for Intellectual Property; fake products may damage brand image
WTO targeted tariff cuts specifically benefit major US products	Protectionist impulses and abrupt policy changes raise non-tariff barriers
US recognized as leader in food service techniques, technology and management	Lack of knowledge about how to handle and use imported products
Growing prepared food sector caters to US strong point	Substitution by Chinese-made products as food industry develops
Improving distribution system gives imported products access to more Chinese markets	Cold chain unreliable outside major urban areas of Beijing, Guangzhou, and Shanghai
Globalization, travel leads to curiosity, willingness to experiment	Long lag time between product order and delivery; high trans-Pacific shipping costs
Importance of face, gift culture boosts consumption of aspirational, high-status food	Lack of serious commitment on the part US suppliers in developing China market

Part II: ROAD MAP FOR MARKET ENTRY

A. Market Structure

1. Target Population

The top economic tier of China's urban population now earn per capita incomes in the neighborhood of RMB 3,600 monthly, or RMB 43,200 (about US \$5,575) per year. Rising disposable income, particularly among white-collar workers, means this segment can now afford to try imported foods. Increasingly, it is fashionable to sample international cuisine, and many urban Chinese have both the desire and means to dine out frequently in upscale restaurants. Consumers actively pursue information about imported food products, often seeking opportunities for new culinary experiences beyond traditional Chinese cuisine.

Increased consciousness of nutrition, food safety, and appearance is also affecting the market for imported foods. Obesity has rapidly evolved as an issue in China, especially child obesity, and demand for low-fat, calorie conscious and healthy options is rising. A number of large-scale school food service related poisoning incidents in 2006 brought safety and natural ingredients for children's food to the forefront of public consciousness. Women are increasingly interested in food and beverages that promise to improve hair and skin health, and seniors seek vitamin-fortified products with real and perceived health benefits. Functional foods with ingredients like n-3 fatty acids, probiotics and antioxidants have also found a growing market in much of urban China.

Major cities like Beijing, Shanghai and Guangzhou have benefited from economic reform and foreign investment, and already boast a well-developed international product market in urban areas. Imported food market growth appears to be particularly promising in emerging city markets (ECMs), where new development efforts and growing integration with the global economy is driving demand for new products. Some of these Chinese cities include Tianjin, Qingdao and Dalian in the north; Suzhou, Wuxi and Hangzhou in the Yangtze Delta; and Shenzhen, Dongguan, Zhuhai and other cities in the southern Pearl River Delta.

Suppliers should be conscious that the cost profile for imported foods is still far higher in comparison to domestically produced products, with only a small percentage of China's population of 1.3 billion is consuming at this level. China's 800 million rural residents' per capita income was only \$308 in 2003. Urban income was higher, \$1,027 per capita, but at those levels little is left for high-end meals. Nevertheless, the top 15% of city dwellers in China can now afford imported food, on a regular basis, and currently represent a market of more than 150 million people, poised to grow exponentially as incomes continue to rise.

2. Distribution

Less than a decade ago, most of the imported products flowing into Mainland China first made a detour to Hong Kong. The trip from Hong Kong to Beijing takes four days via truck and six from Shanghai to China's far western provinces. With economic and policy liberalization along with infrastructure improvements, increasing levels of 'direct imports' have entered China through Shanghai, Dalian, Tianjin, and other ports, improving transport times and increasing market information about the agricultural products consumed in China.

Distribution has made great strides in the major markets such as Beijing, Shanghai and Guangzhou, according to restaurateurs, executive chefs and food purchasing managers. Improved expressways, ports and cold chain infrastructure expedite transportation and delivery. However, outside major metropolitan areas, cold chain distribution is still unreliable and finding consistent supplies can be a challenge. Purchasing managers at major hotels in

some Emerging Qty Markets (ECMs) resort to transporting imported products primarily by air, and even then, there are difficulties. "We commit to a menu, but we can't get the product supply consistently," says one restaurateur. Increasing warehouse space and improving networks between importers and local agents in ECMs have increasingly enabled distributors to keep key items in stock, despite the long lead time for transoceanic orders.

Cash flow presents difficulty for many distributors: buyers, especially large-scale customers like hotels, usually have a pay period of 45-90 days post delivery. Meanwhile, payment for imported food normally takes place 30 days after invoicing, usually upon shipment. As distributors become more professional, fewer suppliers require full payment in advance, but even under the best circumstances, top distributors still need put down deposits averaging 30% or more on meat imports.

Despite improvements in overland infrastructure, distributors say air shipments continues to make up around 10% of their imports by volume and more than twice that in value. Air shipment of meat and dairy products, as well as some fruits and vegetables, is routine. Many report airborne imports face fewer customs and quarantine difficulties compared to imports by sea. Complex quarantine and customs procedures still cause import delays on an all-too-regular basis, although distributors report port of entry is a large variable in the frequency and duration of delays.

Gray Channel

The Hong Kong 'gray channel' is still a primary supply route for products destined for the Pearl River Delta and southwestern China, including Sichuan, Yunnan, Hunan, and Chongqing. Most northern distributors have eliminated reliance on the gray channel or reduced these imports to less than 20% of total volume. Gray channel goods are handled by Hong Kong agents who work with Mainland agents, often based on family connections, across the border in Guangdong Province. Cargo is under-invoiced to reduce tariffs. In addition, some distributors say, it is easier and less expensive to source low-volume shipments out of Hong Kong, rather than landing full containers in northern ports.

However, WTO tariff reductions and general loosening of controls have diminished the advantages of under-invoicing, as the central government continues to crack down on customs tariff and tax avoidance. In addition, the leading edge of growth in the imported food market is moving north, away from Guangzhou, since the cost of transportation often eats into the perceived savings of gray channel product shipments.

Direct Imports

Bustling development across Mainland China has created a high-end food market, with imported food volumes increasing in Dalian, Tianjin (Beijing area), Qingdao, Shanghai, and Xiamen, all of which have modern docks, warehouses and container handling. Customs procedures have become more transparent as standard protocols for individual products evolve port-by-port. However, arbitrary treatment and policy changes still impede or block shipments unexpectedly, and importers complain inspectors are inconsistent and finicky: "They will block something for slight variations in bills of landing," says one importer.

Major distribution options include:

- Full-service distributors (discussed above).
- Third Party Logistics. China has liberalized its distribution industry under WTO rules, and 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. They don't specialize in the food business, so distributors or sales agents are still needed for sales, promotion, and bureaucratic hoops like licensing, labeling, and perhaps most importantly, getting paid.

- Direct sales to end-users. This is limited to high volume customers like fast food and large hotel chains. Post suggests having local agents handle the paperwork and licensing issues to relieve the unexpected hassles, which can cause delays and risk the loss of whole containers of goods.
- US consolidators fill orders for China-based distributors, and also fill direct orders for restaurants and hotels, so you still need to make sales in China. US consolidator efficiency is considered a major advantage for US exporters.
- Hong Kong distributors, who frequently make use of the gray channel. Many have a large network of offices or affiliates inside China, but basically provide the equivalent of 3^d party logistics services. The supplier still remains responsible for promotion, training and developing a market.
- Cash 'n Carry Outlets, such as Metro or Wal-mart, that target large professional customers like restaurateurs for purchase of bulk supplies – they reach the restaurant food service trade directly.

A recent distribution development in China is '4th party logistics', a concept first introduced to the management lexicon by Accenture in 1998. The strategy relies heavily on information management systems handled by an outside consultant. Although this approach is new, market leaders like China's Yoshinoya Fast Food Co. Ltd., have been among the first to embrace it. The system allows buyers to streamline purchasing, distribution and integrate accounting with front-line outlets in real time, substantially decreasing stock loss and market response time. The approach appears to be gaining acceptance in China's HRI sector.

B. Entry Strategy

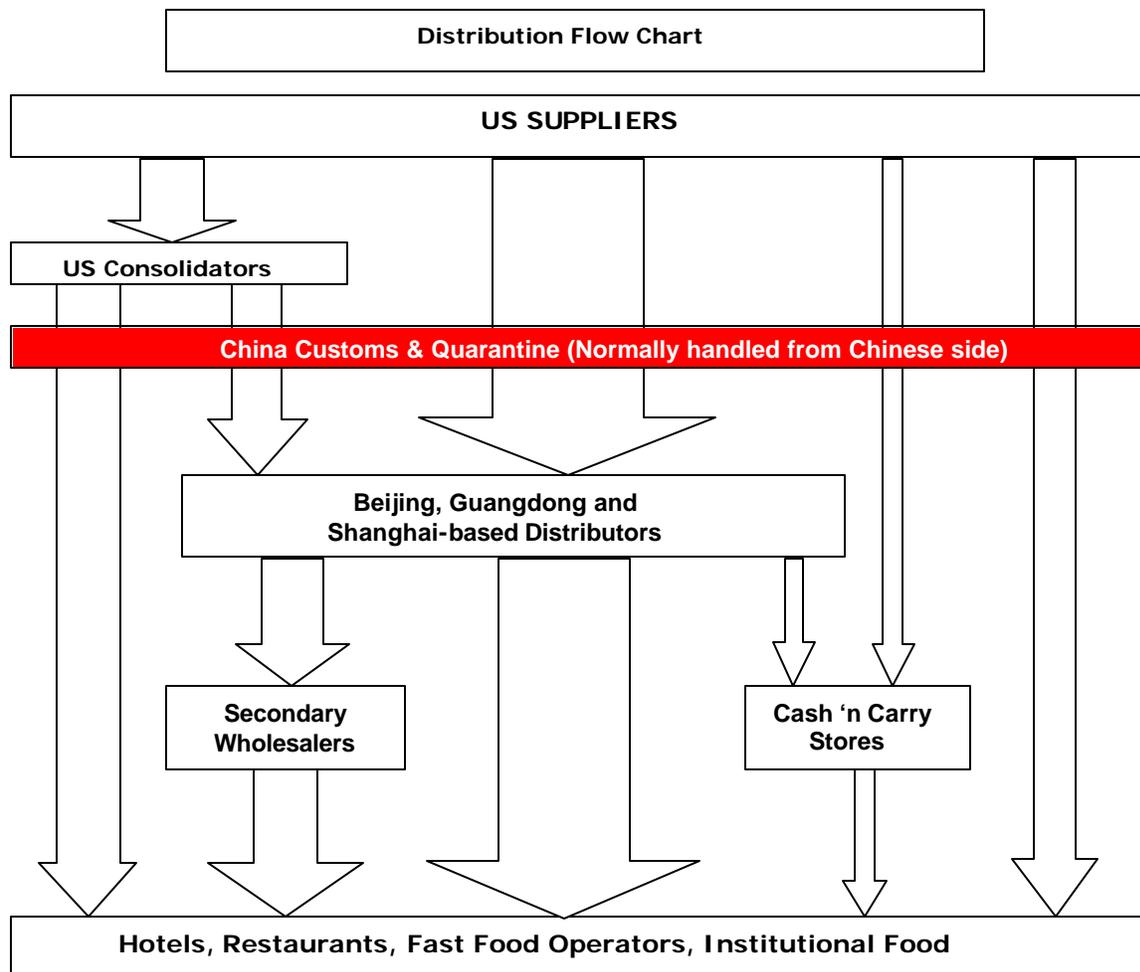
1. Overview

Entering China's market can be incredibly rewarding, but it requires hard work: selling and distributing your product requires face-to-face contact, a special effort to educate the entire value chain, and attention to the details of distribution. Even good distributors in China lack marketing experience and it can also be difficult to get them to focus on promoting your product among the hundreds or even thousands they may carry. Some suppliers conduct marketing on parallel tracks, working with their local distributors but also engaging a small independent marketing and sales force that reports directly to them. Entry strategy should focus on the elements below:

- **Marketing, Sales and Education:** Introducing your product to end-users and persuading them to use it is only the beginning. Chinese distributors and chefs are often interested in using imported products, but usually lack proper handling and preparation knowledge. This can extend even to very basic products, like condensed canned soup or ingredients, etc. and strong educational effort is required.
- **Selecting a Distribution Channel:** At the same time, it is also important to make sure that your distribution channel can provide a consistent supply for your customers. Often, the first question buyers ask about a new product is, "Can I order it

now?" This can be and often is a bit of a chicken-and-egg syndrome for a new supplier in the China market, but an important consideration nonetheless.

2. Marketing, Sales and Education



If there is one mantra that emerges from extensive discussions with industry insiders, it is that the Chinese market needs to be educated from A-to-Z for most imported products. These means showing distributors how to handle and sell the product; developing recipes and demonstrating to chefs and food service staff how to use, prepare and serve it; launching promotional events to entice consumers with the resulting menu, and last but not least, persuasive articulation of why the product makes economic sense in local terms.

Distributors will not make the effort alone, but are willing to work together with suppliers to make a product successful. Several full-service distributors say they focus on building worthwhile brands, which requires building relationships with buyers, providing technical support and training, making joint calls and hosting promotions. "You have to make people truly understand and how to use the product," says Kerry Lu, of Beijing Salate Trading Co.

Successful suppliers have developed a number of strategies to educate the market. On sales calls, they go fully prepared to demonstrate their product. They develop recipes that incorporate the product into Chinese cuisine, illustrating broader versatility. Some bring in chefs and set up a theme promotion at a local hotel for several weeks, often giving intensive and highly focused workshops for local chefs.

Catalogues, recipes and storage instructions are best if provided in Chinese. This is particularly important at Chinese-operated hotels and restaurants, but even at five-star hotels with western-trained executive chefs, a majority of the food service staff will have difficulty understanding labels and directions unless printed fully and clearly in Chinese.

Restaurateurs cite national or ethnic food fairs and promotions as an effective way to reach the ultimate consumer. Many restaurants look for opportunities to do special promotions, capturing customers on the lookout for a new dining experience. In 2006 an American food promotion at the Radisson SAS in Beijing was highly successful – Food and Beverage Manager Marco Liu noted, “diners were interested in the food, but were drawn in particular by their interest in experiencing food culture from the US.” The Radisson plans to hold a similar promotion sometime in the first half of 2007.

The United States Department of Agriculture (USDA) has several export programs that can help support promotion and training. As well, a number of US states and even some cities have offices in China; many cooperate with the US Agricultural Trade Offices in Beijing, Guangzhou, and Shanghai. The State Regional Trade Groups and other USDA market development cooperators also conduct a variety of effective educational and promotional market development programs and/or maintain representative offices in China.

3. Establishing the Supply Channel

The most important advice for U.S. suppliers before entering the China market is to partner with a good distributor. Like many Asian countries, Chinese business culture is heavily dependent on personal relationships between business partners. Face-to-face contact plays a key role in ensuring reliability in situations where legal structure and contract enforcement are vague. Selecting suitable distributors requires effort and cooperation on both sides. US suppliers should work to develop an understanding of target markets within China and clearly define their market expectations for their local distributor.

For their part, the distributor should be able to handle customs, quarantine and any licensing procedures. Some distributors do their own paperwork, while others use import agents. These procedures involve so many requirements and ‘red tape’ that few suppliers or end-users, including Chinese state-owned companies, try to do it on their own. Apart from the licenses and permits, hygiene certificates from the US government are also required for food products. In addition, Chinese import permits, hygiene and quarantine inspection certificates are expected on product entry. Proper labels in Chinese may be required, but stick-on labels are acceptable as long as they have already been applied to the product upon entry. Your distributor should have the ability to facilitate everything mentioned above. Plan ahead and work with distributors to understand the duration of each stage of the process – for example, getting label clearance may take 2 to 3 months and cost around RMB 2,500 (\$325).

It is crucial your importer or distributor is able to make payments in hard currency, or you will have trouble collecting payment. The government has considered plans to make the Chinese Yuan (CNY), also called Renminbi (RMB), into a fully convertible currency, but it may be a number of years before such plans become a reality. Currently, Chinese companies need special licenses to change RMB into US Dollars. Also, RMB exchange rates began to fluctuate

against the US Dollar in 2005– it is important to establish an agreed upon currency and exchange rate system for any payments or costs.

Suppliers of perishable products need to be alert to the cold chain procedure of their distributor, because the infrastructure is not well established. Even in cities like Beijing, Shanghai and Guangzhou, many buyers use infrared guns and in-transit thermometers to check for tampering and temperature variations. “You have to be a policeman; otherwise, they will cheat you.” says the head of one local institutional catering company in Beijing.

4. Protect Your Intellectual Property Rights

FAS China has recently established an IPR Office to address IPR and Labeling issues related to US agricultural and food products. The aim of the Office is to provide direct assistance to U.S. industry and commodity associations and businesses, in their effort to secure registration, as well as to prevent and/or address IPR infringement with appropriate market and legal enforcement remedies.

Although China continues to make efforts to strengthen its legal framework and amend its intellectual property rights (IPR) laws and regulations to comply with WTO obligations, IPR infringement on U.S. agriculture and food products still remains a serious problem. Some examples of IPR infringement issues include:

- “Stickers” and labeling domestic and third-country product with U.S. identifications such as California Table Grapes, California Pistachios, U.S. Wheat Flour, Washington Apples, Wisconsin Ginseng, etc.
- False branding and packaging of domestic and third-country product with U.S. identification such as Sunkist® citrus, Sunmaid® raisins, U.S. wines, and even U.S. grass seed brands
- Counterfeiting or mixing of domestic or third country product together with U.S. food and beverages including poultry, beef, pork, mohair and wool
- Unauthorized sale and use of U.S. PVP protected plant materials and germplasm

The most effective deterrent against piracy is to properly register patents, trademarks, copyrights, plant varieties, geographical indicators, food labels, and other such IPR at home, in China, and third-country markets. Additionally, review FAS China’s online reports CH2049 and CH4059, available from <http://www.fas.usda.gov/scripts/AttacheRep/default.asp>, and the Embassy’s China IPR toolkit, http://beijing.usembassy-china.org.cn/protecting_ipr.html, all of which contain information on China’s patent, trademark, and copyright legislation and enforcement, as well as plant variety protection laws (PVP).

The IPR Office is located in the Agricultural Trade Office (ATO) Beijing. For additional information, contact Mr. Yuanchuan Liang at yuanchuan.liang@usda.gov.

5. Entry Tips

Experienced distributors and buyers offer the following advice for those who wish to enter the China market:

- Take time to study the market. Understand the exporting/importing process from start to finish. Partner with a reliable and capable distributor to execute all necessary importing documents and licenses.
- Having a great product is only the beginning. It is critical to understand the target market and prospective clients before you enter the market. If an international hotel,

restaurant, fast food chain or air caterer is an existing client in the U.S., try to use that as an entrée to the China branch.

- Be sure the products you carry are unique – if there is a similar domestic substitute or established foreign competitor, it may be difficult to compete on price/quality. An alternative strategy may be to enter the market by exploring geographic market segments not yet covered by the competition.
- Many suppliers get excellent market information by scheduling an initial visit to coincide with one of the many large international exhibitions held here in China, such as SIAL China, Food Ingredients China, Food & Hotel China (FHC), or China Fisheries and Seafood Expo. ATOs in Beijing, Shanghai or Guangzhou can provide contact details for show organizers upon request.
- Be financially prepared. Consider all possible costs, such as: license, customs handling, promotion, education and training, freight, tariffs and VAT.
- Unless you are supplying one of the fast food chains or a hotel group, only selected products may ship large volumes. Most likely you won't be able to start with full container loads so consider waiving order minimums during the market entry phase.
- Different regions in China have unique and diverse dietary habits and tastes in food, just as they do in the US. Always start in one region and conduct market tests before entering another. You may need to modify a product to make it conform to regional tastes and purchasing habits.
- Don't be too ambitious. Expand your business only after full confidence in operation in one location. One of the most common mistakes made in the China market is overly ambitious expansion without a solid foundation and loyal customers.
- Work to incorporate locally celebrated holidays, festivals and customs: Chinese New Year, Mid-Autumn Festival, China's annual May Day and National Day vacations, and so on. Western holidays like Valentine's Day and Christmas are also increasingly celebrated here. International sporting events (Olympics, World Cup Soccer) are also very popular, and association with special events like weddings and business celebrations can provide good business opportunities.

Part III: COMPETITION

Imported food accounts for around 24% of the total value of China's food and beverage sector – as such, the imported foods market in China is very competitive with suppliers from around the world battling for market share. Australia, New Zealand, South Africa and the European Union are most likely to supply products that compete with American products. European suppliers in particular provide heavy support for chefs, including regular training.

Future food trends in China include: 1. Increased focus on healthy and nutritious options as obesity and food safety continue to draw attention; 2. Growing popularity of 'fusion' foods as combination of western and Asian flavor is increasingly accepted by consumers; 3. Widespread exposure of western food due to popularity of chained mass-marketers like KFC and McDonald's; 4. Olympic Games as a catalyst for internationalization in food as millions of Chinese are exposed to the catering services during the upcoming games. Self-service, portion control, increased food safety, and value for cost perceptions all should increase the viability and acceptance of western food options here.

In response to consumer demand for healthier foods, both McDonald's and Yum! Brands (notably, KFC) have all introduced alternatives to traditionally perceived high-calorie Western fast food. Yum! launched a Chinese-style fast food chain 'Dongfang Ji Bai' in May 2005, and healthier options like salads and wraps have found their way onto McDonalds and KFC menus.

Imported U.S. food products have an excellent reputation for consistent quality. Chefs exhibit strong loyalty to US beef, despite the fact that availability has been banned in China's market for the last 3 years. French up-market cheese, yogurt and chocolate and Norwegian salmon are also considered premium quality. New Zealand and Australia have a clear proximity advantage in shipping times and cost, and dominate standard dairy imports destined for the HRI Sector here.

Most imported products face at least some locally manufactured and lower priced competition, unless it is something China doesn't produce at all (for example, olive oil). In addition, multi-nationals such as McCormick and Danone manufacture products in China to be more cost effective or to gain market access. And recently, a number of small companies have popped up near major cities, successfully producing highly perishable international foods like raw mozzarella using imported techniques. Quality is improving on domestically produced products; increasingly, chefs and purchasing managers have to decide whether they can substitute imported products with improved local products.

Some buyers believe China will never be able to produce commodities that require large-scale corporate farming operations. For example, China still imports around 70% of its French fries, because Chinese growers have difficulty most years producing potatoes that are consistent in quality and economically competitive.

Counterfeit or fake goods are another competitive factor for US products. When a brand gets established, counterfeit and cheap imitations usually follow. Bad experiences with a higher-priced "imported" product that is actually counterfeit can tarnish brand names and lose customers for years. As a rule, though, fast food chains and high-end restaurants vigorously check to ensure the integrity of genuine products.

US products currently have a slight currency advantage due to the recent RMB revaluations relative to the US Dollar, and exchange rate adjustments have made American products slightly less expensive relative to European or Australian products. However, the differences are still somewhat minimal and any cost savings are often not passed onto the consumer. The RMB is expected to continue its rise against the dollar, but market sources indicate that a major shift is unlikely to occur.

Imports and Competition

Product Category	Major Sources	Strength of Key Suppliers	Adv/ Disadv of Local Suppliers
Beef - Imports US \$10 mil	1. Australia, 89% 2. Uruguay, 7% 3. New Zealand, 3%	Australia is clear leader with US out of the market due to BSE- related restrictions. All sources predict strong US rebound if and when restrictions lift.	China's beef industry is nascent and meat quality not generally acceptable for stand-alone use such as steaks.
Pork - Imports US \$21 mil	1. Canada 71% 2. France 13% 3. USA 6%	Canada was early in the Chinese pork market and export promotion increased distribution to China's major ports.	Domestic pork industry is large, but made up of small farms with low production efficiency, poor consistency, and variable quality.
Lamb - Imports: US \$50 mil	1. New Zealand 59% 2. Australia 39% 3. Uruguay 1%	Unsurprisingly, global leaders Australia and New Zealand make a strong showing here	China's well-developed domestic lamb industry is centered in Inner Mongolia and particularly well branded.
Poultry - Imports: US \$420 mil	1. US 67% 2. Brazil 26% 3. Argentina 5%	Brazil and Argentina are aggressively seeking to build on their low-cost production to expand share and attract Chinese investment.	China's poultry industry has modern producers who are expanding into export. Much of the industry still produces live chicken for retail sales.
Fish - Imports: US \$2.5 bil	1. Russia 47% 2. US 14% 3. Japan 8%	Much of Russia's exports are fish-meal; US leads in fish fillet category with 8,639 MT	China has a large and pervasive international fishing fleet
Shellfish - Imports: US \$600 mil	1. Canada 33% 2. Russia 14% 3. Greenland 7% (US 3%)	The vast majority of Canadian imports are processed in China for re-export, not consumed on the domestic market. Proximity plays a key role for Russian imports	China has a large and aggressive domestic aquaculture industry that produces shrimp and other shellfish.
Dairy - Imports: US \$400 mil	1. New Zealand 47% 2. US 15% 3. France 10%	New Zealand is an aggressive supplier and has an advantage in shipping time. France has a strong reputation among high-end cheese buyers.	China's dairy industry is growing very rapidly, but still in an early stage of development. It produces milk and yogurt but doesn't really compete in cheeses or butters.
Fresh Temperate Fruits - Imports: US \$80 mil	1. US 55% 2. New Zealand 21% 3. Chile 15%	US leads in citrus, and is a close second to Chile in apples and pears; New Zealand in counter seasonal in stone fruit	China's fruit production has been rising and steadily improving in quality
Nuts - Imports: US \$103 mil	1. Russia 22% 2. South Korea 18% 3. US 15%	Russia is the leading supplier of pine nuts; US strong in pistachios and almonds	China is a large walnut grower as well as many other temperate nuts, but quality remains low.
Sauces and Condiments - Imports: US \$71 mil	1. Japan 57% 2. Taiwan 9% 3. US 8%	Leaders produce popular Asian styles. The US leads among non-Asian suppliers.	Multinational suppliers are gaining market share with domestically made products.
Soups, Broths, Preparations - Imports: US \$5.6 mil	1. US 34% 2. Japan 32% 3. Hong Kong 9%	The US is considered a technology leader in this field.	Cheap labor meant slow growth in this market, but demand for prepared products is escalating rapidly.
Beverages - Imports: US \$586 mil	1. France 28% 2. UK 17% 3. Australia 5%	US ranks 3rd overall for non-alcoholic beverages, 6th in wine and 9th in beer. France's strong lead is due largely to its dominant wine position.	China's fruit juice industry is well developed; wine is of low and/or inconsistent quality. The highly competitive domestic beer industry includes multinational players like Budweiser.

Fresh Vegetables - Imports: US \$755 mil	1. Thailand 64% 2. Vietnam 16% 3. Canada 8%	Thailand and Vietnam profit from proximity and are now able to meet food safety standards. US imports are negligible.	Production of fresh vegetables has increased consistently and imported products have been substituted domestically in recent years.
Frozen Potatoes Imports: US \$794 mil	1. US 94% 2. Canada 5.5% 3. Thailand .2%	The US is the clear leader and preferred supplier.	China still has difficulty producing consistent product for the QSR French fry market

China Customs Data, retrieved from World Trade Atlas 2007

Part IV: BEST PRODUCT PROSPECTS

Interviews with HRI food service professionals repeatedly confirm that US food exporters should select top quality products for export to China. US foods benefit from expectations of high quality, attractive appearance, convenient package and food safety. On the other hand, it is difficult for most US food products to compete with Chinese domestic products on price, particularly for those foods in demand by the HRI market. Instead, suppliers should consider targeting niche as well as regional markets with top-quality products that are unique, healthy, and nutritious.

U.S. beef has been banned for import in China since December 2003 due to BSE. Food service professionals in the HRI sector remain committed to using US beef due to the consistent and unparalleled quality, and note it easily out competes all competitors on flavor and appearance. As soon as the ban is lifted, demand for US beef will exceed 2003 levels. Salmon, from a variety of country suppliers, is another popular import item, used widely in Japanese kitchens. American lobster, particularly live lobster, also generates much interest, however, high cost and losses associated with shipping live products have resulted in a market dominated by Australian lobster. U.S. lemons, oranges, and apples from the US remain strong competitors in the imported fruit market when the season is low for domestic products. Tree nuts are also very popular in China, especially US almonds and pistachios, as a result of the health and nutrition benefits.

As China's economic development continues and interest in processed food grows, the secondary production of goods, such as meat and fish, may well become attractive to manufacturers and these agricultural sub-sectors may also manage to profit from multinational investment. The secondary stage of processing such goods, for example, the sliced meats and pre-prepared chickens etc., has had a huge impact on sector sales. Also, ready-to-use and value-added products were considered unlikely prospects only a few short years ago due to perceived kitchen labor surplus. Nowadays, China's HRI market is increasingly demanding ready-made, pre-cooked and portion-controlled sauces, soups, pizzas, vegetables, fish fillets, meat products, and frozen dough.

Likewise, organic food in China could prove a strong long-term opportunity. Presently, due to lack of local understanding of organic products and little investment in the sector, the industry is under-developed with official organic agriculture representing far less than 1% of domestic agricultural production. The higher price of organic products and lack of awareness of the concept means China's organic products market is still in the initial phases. However, with careful promotion, high-quality imported organic products appeal to hip young professionals and their grandparents who remember when it was safe to eat an apple without peeling it first. These products have good potential in China's increasingly health and food-safety conscious market.

In the Market with Potential	Present and with Good Potential	Products not Present or Diminishing
Seafood (lobster, tuna, salmon, mussels, seaweed) Beef Lamb Pork Veal Chicken paws Cream Premium yogurt Nuts and dried fruit Condiments (mustard, meat tenderizer, hot sauces) Frozen potatoes (French fries, wedges) Potato preparations Wheat flour Pasta Olive oil Coffee Chocolate Breakfast cereals, including muesli Premium fruit juices Fruit (grapes, grapefruit, oranges, Kiwi fruit) Frozen berries Wine Beer Bottled water	Organic foods, Pre-cooked sauces, like bolognaise, portion control fish fillet and meats, cheese, Butter, Mexican, South American food, other ethnic food items like Indian, Italian, etc. Bulk cheese for catering use. Colors and flavors, canned and maraschino cherries. Turkey and other poultry.	Some Fresh Fruits (domestic substitution of apples, pears) Mayonnaise (JV manufacturing in China) Ketchup (JV manufacturing in China) French jam (JV manufacturing in China) Simple cereals (corn flakes, made in China) Baked potatoes Onion rings Red cabbage (domestic substitution) Orange juice (domestic substitution) Macadamia nuts (some Chinese say these are too oily)

Part V: Post Contact and Additional Resources

For further information about the China market, as well as updates on our upcoming events and activities, please visit our website at www.usdachina.org or contact one of USDA's six offices in China:

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