

Distributor Development Program for Emerging City Markets

A proposal submitted to the Central Fund of the USDA's Emerging Markets Program
by
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Target

Markets: This project focuses on the second tier cities in China beyond Shanghai, Beijing, Guangzhou, including Chengdu and Chongqing. Each ATO will identify two to three second-tier cities which have seen double-digit GDP growth in the past five or more years and per-capita incomes close to or even surpassing that of China's major coastal cities.

Current

Conditions: China's government has spent the last decade developing improved infrastructure in second tier cities through heavy investment, construction campaigns and other mandates. Now, local governments in many Emerging City Markets (ECMs) are working to duplicate the same preferential economic policies that drove China's first boom, through reduced taxes and increased incentives to encourage international trade.

International retailers (Carrefour, Wal-Mart, Metro Cash & Carry, and Tesco) are following the pattern of economic development and expanding rapidly in these ECMs. Outbreaks of SARS, avian influenza and numerous food and drug tainting scandals disclosed in the past several years have drawn closer public attention to food safety and hastened the decline of less sanitary wet markets. Rich consumers are more inclined to buy imported food products as imported foods generally enjoy a favorable image of safety, high quality and nutrition.

Far from being a single unified market, the China market is a highly fragmented. Distribution channels, particularly outside the international retailers noted above are highly inconsistent and pose a significant barrier to imports of U.S. high-value products.

Distributors in the three major cities of Shanghai, Beijing and Guangzhou are reluctant to go to second tier cities due to their unfamiliarity with them, as well as personnel and capital limitations.

While many international retailers have a unified purchasing and logistics, much of the retail distribution in these ECMs is handled on a city by city basis, with stores receiving most imports through local distributors. Stores negotiate highly favorable terms that include free return of unsold products, high listing fees for new products, and credit terms. The market risk is effectively passed onto the local distributors.

When selecting new products, local distributors in the ECMs market still rely on their counterparts in the three major cities to introduce and sell products to them, which increase both product cost and entry time to stores.

In a nutshell, distribution has become a major bottleneck to introducing U.S. products to ECMs throughout China.

Constraints: ECM Distributors have limited knowledge and brand awareness of U.S. products: FAS/China has successfully reached out to a number to ECMs in past years. During interviews with local distributors, FAS/China found that few of them truly knew the products they were carrying. When they selected products from their counterparts in the three major cities, they made decisions primarily based on product appearance, taste or the limited information they could gain from their counterparts in the three major cities. In a word, the products sell themselves.

Capital and operational risks in carrying imported products:

Capital risk: When distributors in these ECMs buy products from their counterparts in the three major cities, they need to pay the full amount to get the products, but when they sell to retailers, the credit period may take two to three months or they will sell on a consignment basis. Without ATO and cooperator support, this limits distributors' ability to introduce new products to regional or international retailers.

Operational risk: Because distributors in ECMs buy products from their counterparts in the three major cities, it lengthens the product delivery time. For example, even for cities within a 2-3 hour drive from Shanghai such as Hangzhou, Ningbo and Nanjing, it often takes distributors 3-4 months after a product's production date to receive

goods, not to mention delivery delays further inland. On the other hand, those distributors' clients -the retailers- have generally strict requirements for products' expiration dates. Products with 4-6 months from their expiration date may not go onto store shelves, leaving typically only a 4-month sales period for distributors. Within this short sales period, if products do not sell well, distributors have to bear the loss themselves.

Lack of Retailer Understanding of Supplying and Marketing: Retailers, including international retailers, lack an understanding of the quality and safety attributes that mark U.S. agricultural products. The lack of product information results in product mishandling and ineffective marketing. While cooperators are often responsible for these training efforts, an ATO coordination role is critical. As a result, relatively long shelf life and low turnover of imported products is the norm in second-tier market and the result is that even retail giants, like Carrefour and Metro, often avoid imported products in favor of higher volume products.

Project

Objectives: This ECM distributor development project is part of an FAS/China comprehensive market development approach to broadly address market access barriers and strengthen FAS/China's ongoing effort to explore and expand U.S. products availability in ECMs by:

1. Creating a FAS/China-wide distribution and retail development team that would coordinate first and second tier retail development.
2. (Through this team), reducing intermediary links between U.S. exporters/manufacturers and distributors in ECMs markets, and establishing direct links between them.
3. Stimulating purchases of U.S. products in these ECM cities.
4. Establishing and strengthening the presence of U.S. products in these ECM markets and building relations with retailers and distributors in ECM markets.

Rationale: Business in China still relies heavily on relationships between individuals; the distribution network is fragmented and product availability depends on distributors in these ECMs. A push strategy targeting distributors in these ECM markets will solve the bottleneck problem in the merchandise and supply chain for U.S. products in these ECM markets. Motivating aggressive distributors in these ECMs to buy directly from U.S. suppliers will stimulate purchases, reduce product cost and lead time, and increase the presence of a wider range of U.S. food products.

By establishing an FAS/China distribution and retail team and coordinating this program nationally, ATO/China will be able to effectively implement this program. In the project's initial stage, a large investment is needed. Consumers in the three major cities have already been exposed to an

increasingly wide range of high quality imported food for over a decade. Demand for imported food is beginning to plateau among Shanghai, Beijing and Guangzhou consumers who know exactly what they want and who already have access to a wide range of global brands. In contrast, in the last two years, ECM markets have seen a substantial increase in imported food products. For example, in the past two years, Hangzhou went from importing around US\$86 million to over US\$142 million in food products, a whopping 65% surge (see World Trade Atlas, China customs data 2004—2006 for imports from the U.S. by district for product group “Food Products”). In Sichuan, international trade is up more than 50 percent in the first half of 2008 and growth in both Chengdu and Chongqing, the largest second tier cities in southwest China, is up more than 15 percent. The time is ripe to cultivate and motivate distributors in these ECMs to generate business leads for U.S. products.

ATOs in China are already conducting a wide range of market development activities in their respective ECM cities, including working with those local distributors, to broaden the range and availability of U.S. food products in those cities. For example, during the past year, ATO Shanghai has been in intensive discussions with distributors in the ECM cities of Wuhan and Wenzhou, and has already developed plans to coordinate our market development projects with those distributors in the future. This project will be critical for FAS/China to strengthen and expand this distributor network for U.S. products in ECM cities.

Description

Of Activity: *Funding is requested only for the first year of this project.* However, FAS/China plans to submit follow-up proposals in the future. We envision a two-three-year commitment to these markets, and will of course evaluate our results and assess our progress after each phase. We estimate that sponsorship totaling \$10,000 will be generated from Cooperators and distributors under 12X.

First Year: Market research and identify appropriate distributors for retail and food service opportunities in ECMs, followed by a reverse buying mission to the U.S.

Choose two or three ECM cities in the Beijing, Chengdu, Guangzhou, Shanghai and Shenyang regions as target markets, conduct field surveys, including first hand information on:

1. Best sales for imported products and U.S. products
2. Potential imported products and U.S. products for the market
3. Main competitors for U.S. exporters in each product category
4. Logistic and distribution channels in ECMs
5. Retail store entry requirements

6. Consumer behavior such as taste preferences, price sensitivity, and new trends, imported product consumer demographic characteristics
7. Any specific constraints facing imported products
8. Distributor and retailer capability, such as company scale, capital, distribution network, main sales channels, etc.

For fragmented distribution chains, the FAS/China distribution and retail development team would identify a short list of target distributors with interest, experience and capital that are prepared to establish their own overseas channels. Participating ATOs will organize ECM distributors and retailers to attend international trade shows held in the three major cities, such as SIAL and FHC in Shanghai, to assist them in establishing direct contacts with U.S. exhibitors. ATOs will set up one-on-one meetings between ECM distributors/retailers and U.S. exhibitors, and organize product introduction seminars that feature U.S. exhibitors' products, which will provide more product knowledge and information to them, further building U.S. product brand awareness.

For international retail chains, the FAS/China distribution and retail development team would coordinate product handling and market promotion programs to educate procurement departments of international retailers about introducing new product lines. The team will also coordinate with cooperators on retail market development and promotional activities nationwide.

Selected ECM distributors will be invited to participate in a reverse buying mission to the U.S. to establish direct links with selected food manufacturers to further help them gain product knowledge and establish direct links with their U.S. suppliers, which will motivate them to purchase/import directly. After they return to China, several training seminars will be held at selected retail outlets in each ECM city to introduce U.S. food products to external customers and internal staff of the selected retailers, which will help distributors and retailers sell their new products and help to cement the relationship between retailers and distributors.

Second and Third Years: Further distributor development activities in ECM cities and retail promotions in certain ECM cities. After the training sessions have been completed, each ATO will work with the selected retail partners in ECM cities to conduct a two-week "American Food Festival" in each ECM city to promote both existing and especially new-to-market products to generate consumer traffic in the store, expand U.S. products' market share, and strengthen the image of U.S. products. The results of these promotions will complete our market research information in these ECM cities and provide us with first-hand information about local consumer demand.

As mentioned above, with the ECM local government policy of supporting an increase in international business, and the rapidly increasing demand for imported food products on the part of consumers in these cities, this is a most opportune time to shorten the distribution chain, decrease product costs, and expose local distributors to a wider range of U.S. products, all of which will benefit U.S. exporters and manufacturers in the long run.

Activity

Budget:

US\$197,000 requested under EMP Funding.

Emerging Markets Program

Cost Breakdown:

Item	Description	Amount (US\$)
<i>Market Research</i>		
1	Staff travel to ECM cities to interview distributors and retailers (US\$1,500x 3 ECMs x 4 ATOs)	18,000
	<i>Sub-total</i>	<i>18,000</i>
<i>ECM Distributor Development</i>		
1	Organize ECM distributors and retailers to attend trade shows in three major cities (US\$3,000 x 3 distributors/retailers x 4 ATOs)	36,000
2	One-on-One meetings: host meetings for ECM retailers with major city-based suppliers (US\$2,000 x 3 ATOs)	15,000
3	Reverse buying missions to the U.S. (US\$3,000 x 4 persons x 4 ATOs)	48,000
4	ECM retail supports of combination of in-store promotion, training and marketing support for distributors to introduce new U.S. agricultural products	40,000
5	Coordinated training and promotion program	40,000
	<i>Sub-total</i>	<i>179,000</i>
	<i>Total</i>	<i>US\$197,000</i>