

Under the Table

A Look at China's Food Processing Industry

Rising disposable income and urbanisation continue to drive China's economy and the food processing industry is no exception. Between 2001 and 2006 the industry grew at a compound annual growth rate of 20 per cent to reach approximately USD 288 billion. The industry is expected to continue to expand as consumers increasingly value the convenience and variety of processed foods.

Only about 30 per cent of food in China is processed, compared to 60-80 per cent in Western countries. The current level suggests significant room for growth in the domestic market, especially in urban areas, as well as a huge opportunity to introduce foreign foods and ingredients to local tastes. The picture isn't entirely rosy though. Like so many things in China, statistics have to be understood within the cultural context. Widespread adoption of processed foods may never reach the levels of their Western counterparts, as Chinese consumers tend to prefer fresh food. Furthermore, a spate of safety scandals concerning both exported and domestic food has cast a shadow on the industry.

Key Market Dynamics

China as an Exporter of Processed Foods

China is an important export manufacturing base of processed food as well as of food in general and it became the EU's fifth largest importer in 2005. Demand for exports has been driven by rising living standards in other emerging markets such as India and Southeast Asian countries. Additionally, the export market has benefited from growth in outsourced food processing to China. However, international concerns regarding food safety may contribute to a slow down in the short-term. Indeed, China experienced a decline of exports to Japan in the first quarter of 2008 as a result of tainted frozen dumplings exported to the country.

Growth in exports may also be slowed by domestic policies aimed at shielding the country from surging global food prices – take China's grain industry as an example. Despite Government's push for self-sufficiency in grain production, rising prices abroad

threaten to channel the country's production to the export market, rather than to satisfy local consumption. To maintain current levels of grain sustenance and allay public anxiety over rising food prices, China is likely to impose heavier export restrictions on grains.

Regulatory "Encouragement"

China's Eleventh Five Year Plan (2006-2010) designates food processing and packaging as an "encouraged" industry. The Foreign Investment Guidance Catalogue (effective 1 December 2007) continues to list the processing of farm products and food processing as "encouraged". Essentially, this means that qualified foreign invested enterprises in the sector may enjoy tax incentives and favourable land use rights, as well as lower infrastructure and utility fees.

Industry Consolidation

Consumers are driving industry consolidation as they increasingly purchase processed food from more well-known brands, or those which they perceive as more reliable. Consolidation is creating larger brands capable of investing more in equipment, marketing, distribution, etc.

Meeting International Standards

There exists a disparity between large and small firms and their ability to comply with international standards. Heightened quality standards enacted by the International Organization for Standardization (ISO) and foreign governments force manufacturers to continually upgrade their processes. In China, such standards are often only met by large firms.

Food Safety Fallout

Recent food safety concerns have drawn international attention to an industry often characterised by fragmented supply chains and inconsistent agricultural practices. The government has responded in two ways: by building a food safety system for exports and by strengthening domestic food safety standards through implementation of inspection and testing systems for consumer products and agricultural commodities. Whether or not these measures can effectively trace problems and enforce standards remains to be seen.



Lynn Ng
Marketing Manager
The JJ Group



Blake Street
Marketing Assistant
The JJ Group

The market has benefited from growth in outsourced food processing to China



Only about 30 per cent of food in China is processed

Government intervention will continue to play a large role in the short-term, by forcing domestic firms to comply with new standards. However, in the long-term, as end-consumers become more willing to accept higher prices as a means to ensure quality, producers will, in turn, increasingly invest in better practices and the machinery that supports them.

Opportunities in Equipment

The industry trend towards improving quality creates unique opportunities for suppliers of food safety and testing equipment. In general, top producers still rely on imported machinery for its quality and dependability over domestic alternatives. Meanwhile, exporting producers are now required to have in-house laboratories to test for pesticide residues and producers serving the domestic market are turning to third parties that provide testing services to ensure quality. These factors have contributed to an increase in demand for imported testing equipment. Manufacturers such as US-based Promega and Swiss-based Metrohm have succeeded in increasing their presence amid these market conditions.

Growing consumer demand is another driving force for many sectors in China, including the beer industry. China is the world's largest producer and consumer of beer, yet rising disposable income continues to fuel demand, providing additional room for growth. In 2007, beer sales grew by 13.8 per cent to 39.3 billion litres. Scrambling to meet consumer demand, manufacturers are keen to upgrade to higher capacity machinery capable of producing between 50,000-100,000 tonnes per year. At present, about 85 per cent of existing machinery has operating capacities below 50,000 tonnes per year. Because Chinese equipment generally lags behind foreign brands in terms of speed, technology and efficiency, most large beer producers look to importing equipment.

Competitive Landscape

There are approximately 2,500 food processing equipment manufacturers in China, of which

the majority are small Chinese firms. Most of these companies have a limited product range, sometimes only manufacturing one type of equipment. Although overall quality has improved in recent years, their products are still plagued by high energy consumption, sanitation and safety issues, and a low degree of environmental friendliness.

Foreign manufacturers tend to serve the large food processors, including foreign-invested enterprises. Major players are from Europe (Germany, Italy, Denmark, etc), Japan, and the US. They differ from Chinese manufacturers in that many can offer turn-key solutions across a wider range of products. For example, they may provide design, engineering, and installation of complete processing and packaging lines, rather than only selling individual machines.

Taiwanese manufacturers have positioned themselves in the middle of the market. They usually offer better technology and quality than Mainland Chinese manufacturers, but at lower prices than foreign companies. On average, foreign machinery is priced at least 40 per cent higher than Chinese machinery.

Trade Policy

The Central Government generally encourages local assembly and development of advanced technologies through its use of tariffs. The approach is two-pronged: Critical components that are more difficult to find domestically often have lower tariffs when compared to more general components that can be easily found locally; equipment assembled outside China incurs high tariffs, with the exception of high tech machinery currently unavailable to domestic suppliers.

Looking Beyond the First Tier

Besides the more established Tier I markets of Beijing and Shanghai, significant opportunities lie in fast growing Tier II cities. These markets tend to offer tremendous potential in terms of market growth and cost savings. Consider Chongqing, China's youngest and largest municipality with a total population of about 30 million. According to the municipal government, per capita GDP rose more than 15 per cent to RMB 14,622 (USD 2,005) in 2007. In the same year, total trade value reached USD 7.45 billion, up 36 per cent from the previous year. Astounding statistics aside, Tier II markets are by no means ubiquitous in their levels of investment, infrastructure development, government transparency, etc.

There are approximately 2,500 food processing equipment manufacturers in China

Top Regional Markets for Food Processing



In order to understand which Tier II markets offer the best opportunities, both explicit and implicit costs must be considered. For example, a local government may provide tax and land use incentives which significantly reduce explicit costs compared to a Tier I market; but, if the region lacks access to qualified labour or related professional services, the firm will have to spend a great deal more time and money recruiting and training personnel.

One example of a Tier II market offering a good combination of industry specialisation and infrastructure relevant to food processing is Qingdao. As the largest seafood processing base in the country, Qingdao plays an integral role in China's position as the world's largest seafood exporter (USD 9.7 billion in 2007) and fourth largest seafood importer (USD 4.7 billion in 2007). Hard infrastructure includes the Qianwan deep water port, its close proximity to Korea and Japan (the world's largest importer

of fish), numerous domestic and international transportation links, etc. Soft infrastructure includes 23 universities supporting research and attracting talent – a hotbed for marine sciences – and a growing tourism industry.

Wrapping It Up

Domestic equipment manufacturers are constantly improving production techniques and product quality. To succeed in this environment, foreign firms must leverage superior technologies and convey competitive advantage through sound marketing. For producers of processed food, rising demand will continue to shape the industry both domestically and abroad. Firms looking to tap into China's burgeoning consumer market should be prepared to invest significant time and effort in developing strategies to accommodate evolving consumer preferences. Those looking to export from China should focus on ensuring product quality through adequate investment and due diligence. ■

Qingdao is the largest seafood processing base in the country

PROFILE

The JIJ Group is a one-stop service-provider assisting foreign companies to enter or grow in the China market. Having served more than 400 international clients, the firm has extensive experience in assisting foreign companies strategise for China. JIJ's services include Market Consulting, Corporate Formation, Human Resources, Tax & Accounting and Business Process Outsourcing. For more information, please visit www.jijgroup.com or email to consulting@jijgroup.com.

CONTACT

Lynn Ng | Marketing Manager | The JIJ Group – Solutions for China Entry & Growth

Blake Street | Marketing Assistant | The JIJ Group – Solutions for China Entry & Growth

Suite 603-605 | Oriental Center | 699 Nanjing West Road / 31 Wujiang Road | 200041 Shanghai | P.R. China

Tel: +86 21 5211 0063 / 5211 0068 ext. 853 | E-mail: consulting@jijgroup.com | Web: www.jijgroup.com