Agriculture and Agri-Food Canada Agriculture et Agroalimentaire Canada Canada

The Dairy Market in the Yangzi Delta Region

Canadian Consulate General, Shanghai

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Introduction

In the past, it was believed that local Chinese people were lactose intolerant thus, the dairy industry was limited in China. Now, it is well known that this fact is only true for selected inland areas of China where some of the local Chinese people lack the physiological enzymes to break down the lactose for nutrients.

Many Chinese people have had little exposure or opportunities to use quality dairy products. Through increased exposure to the health benefits of dairy consumption, the Chinese people are learning to use dairy products such as butter, cheese, fresh milk, ice cream and yoghurt. This is reflected in the rising rate of dairy products' consumption and import of dairy products.

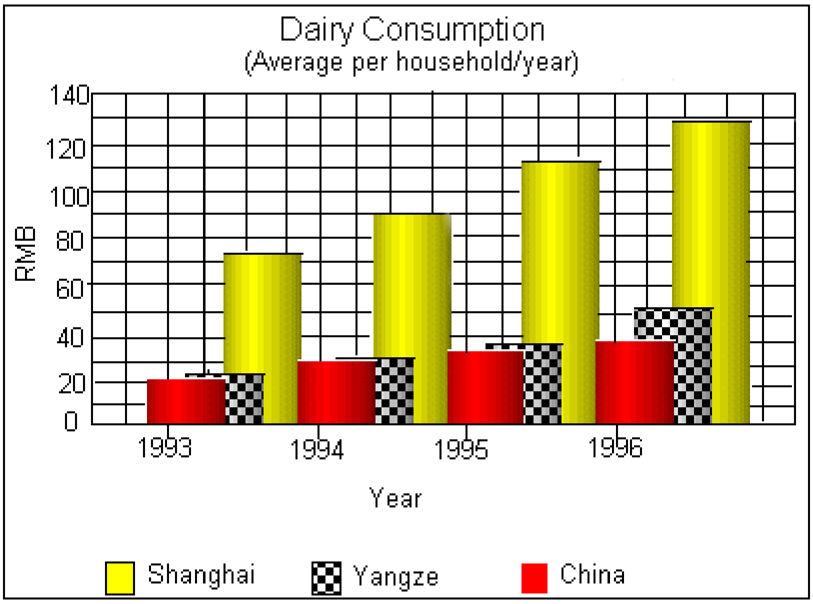
Consumer Behaviour

The most popular dairy product enjoyed by local consumers is yoghurt, which accounts for approximately 80% of all consumption. Following yoghurt is milk (powdered and fresh), ice cream, cheese and butter. Liquid and powdered milk is showing the fastest growth in retail sales and volume of all products.

Local consumers buy their dairy products based on quality. They prefer imported dairy products because taste and quality surpass local brands. Ice cream and yoghurt, for example, are favourite treats of local Chinese people, especially during the hot summer months. Most ice cream is produced locally by foreign brand names (e.g. Buds and Walls) under joint-venture operations but some ice cream is still imported for use in high-end restaurants. Ice cream and frozen yoghurt sales have grown an average of 20% annually for the last three years.

Some dairy products are successfully marketed as health snacks. For example, ice cream is advertised as a nutritious snack for the elderly while fresh milk is marketed as an essential health supplement for the young.

Also, marketing has been strongest in the affluent populations of coastal cities where people are more educated and can afford to buy dairy products. For example, cheese and butter sales are most successful in Beijing, Guangzhou, Shanghai and Tianjin where there is a sizeable expatriate population to complement and shape dairy products consumption and sales.



Source: 1997 China National Statistics Yearbook

Import and Export

In 1996, Canada exported a total of USD$ 325 126 (CAD$ 464 466) of dairy products to China. Although statistics indicate Hong Kong is the largest exporter of dairy products to China, the figures are misleading because, in most cases, Hong Kong is an acting distributor for leading supplier nations like Australia, New Zealand, the Netherlands, France, Switzerland and Denmark.

Many foreign dairy products are produced and/or marketed in China by joint-venture production facilities. Danone, Kraft, Nestle, and Unilever are some companies that have successfully set up joint-venture production facilities to produce yoghurt, cheese, ice cream and butter.

In order to succeed in the local market, foreign companies have to understand and cope with the regional characteristics of each local market they enter. Provinces have their own unique taste preferences as well as different infrastructure developments. Inland provinces, and those farthest from the coast, have the least developed storage and distribution systems, severely limiting the production of some food products.

For example, Danone locates its dairy businesses in various geographical regions to meet logistic and storage necessities. They have separate companies in Guangzhou and Shanghai. In Shanghai, they have a joint venture with a local company, the Shanghai Dairy Corporation, to make fresh and flavoured milk. They also have businesses with local Chinese partners in Shenzhen, Wuhan, Hangzhou and Hebei so that their products are available to the local Chinese people in those regions.

Import Regulations

Dairy products will have to pass through the following bureaus for inspection when they are being imported, and prior to customs clearance:

- The China Commodity Inspection Bureau checks products for quality, weight, and quantity.
- The China Animal and Plant Quarantine inspection checks products for health and sanitation.
- The China Health Inspection Bureau will test for residues of pesticides, antibiotics and other visible and non-visible problems. This bureau also administers and approves labelling requirements for processed food products.

If a dairy product is fully processed and will not be re-packaged in China it may fall under the new labelling requirements as administered by the China Health Inspection Bureau. (See below)

Barriers to Entry

- **Import tariff rates**: Tariffs are a major barrier preventing foreign companies from being competitive in China. High tariffs force costs for products to increase thus, the retail value for imported products is higher than products made locally or by local joint ventures.

  Import duties for dairy products range from 25% (for milk and cream) to 50% (for yoghurt) plus 17% value-added tax (VAT). However, different ports of entry may charge different entry rates on the same or similar products. Because there is flexibility at the local level in deciding whether to charge the official rates, often the actual duties are a result of negotiations between business people and Chinese custom officials.

  To avoid high tariffs, some foreign companies resort to using grey channels to import products via Hong Kong or Guangzhou. This method was very often used in the past, however it is decreasing as regulations become increasingly enforced. Companies suffer stiff penalties if caught. They will most likely be fined and furthermore, may be forbidden to do business in China for an extended period of time.

- **Labelling Law**: The Labelling Law, effective 1 September 1996, regulates the content of print on foreign food packages. Although this is a significant expense for companies, labelling is necessary to protect local consumers. If necessary, local consumers can contact the manufacturer shown on the label for product complaints.

As of September 1, 1996, imported food items must have a label with the following information (minimum) in Chinese:

- Product Name(s)
- Date of production
- Ingredients
- Net Weight
- Country of Origin
- Shelf Life, Expiration Date
- Method of storage
- Importer
- Manufacturers' address

Critical Concerns

Critical concerns specific to the importation of Canadian dairy products to China include:

- **Distribution**: This is the largest hurdle for foreign companies selling dairy products in China. Due to China's underdeveloped infrastructure, inefficient distribution system, and lack of proper storage facilities, companies report as much as 20% of their products are spoiled during transport. Also, only 48% of all retail outlets around the Shanghai area have dairy counters. ***For more detailed information, please refer to our "Food Distribution Systems in the Yangzi Delta Region" report, available through the Canadian Consulate General, Shanghai.***
- **Determining the Chinese palette**: To succeed in the local market, foreign companies need to conduct thorough consumer surveys and research to determine consumers' taste preferences. For example, a European dairy company investing in China discovered that local consumers prefer mild and processed cheeses.
- **Consumer education**: Marketing a new dairy product that does not have a counterpart in the local market can be challenging and costly. However, good marketing is necessary to inform and convince consumers of the benefits and quality of the imported dairy products.
- **Competition**: In the local markets there is intense competition with domestic companies for consumers. Aggressive advertising and marketing campaigns are required to inform and persuade consumers to try and accept foreign dairy products. Furthermore, to compete, foreign companies must satisfy consumers by offering quality products that suit the local palate at low prices.

Nestle is an example of one American company with a joint-venture operation in Shanghai. They developed aggressive marketing and advertising campaigns and conducted thorough local research and succeeded in the local market with their powdered milk. Other successful joint ventures include Holland's Campina, Hong Kong's Klim and New Zealand's Anlene and Domix.

Conclusion

Dairy product consumption in China is rising steadily. With a market of 1.2 billion people, there is great potential for Canadian dairy producers to make inroads, particularly in ice cream and whey products. While dairy products are readily available in the large cities of Beijing, Guangzhou and Shanghai, inland regions are underexposed to dairy products because of poor distribution and storage facilities. To capture the less developed market niche and minimize storage and distribution problems, companies like Danone have successfully set up joint ventures in a range of cities.

Although import tariffs and taxes for dairy products remain high and drive up costs for foreign companies, as of 1 October 1997, China began the first round of tariff reductions en route to WTO membership.

Follow Up

The Canadian Consulate General's Agriculture and Agri-Food Office maintains ongoing relationships with local importers, wholesalers, agents and outlets. The office also organizes and participates in numerous promotional activities aimed at generating business for Canadian firms in this sector. Firms interested in taking advantage of these relationships and activities in their efforts to do business in this market would be well advised to stay in touch with us, as follows:

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