



USDA Foreign Agricultural Service

GAIN Report

Global Agriculture Information Network

Template Version 2.08

Voluntary Report - public distribution

Date: 3/16/2007

GAIN Report Number: CH7403

China, Peoples Republic of

Market Development Reports

Emerging City Markets: The Next Economic Miracle

2007

Approved by:

LaVerne E. Brabant
U.S. Embassy, Beijing

Prepared by:

Even Rogers Pay

Report Highlights:

China is home to more than 100 cities with urban populations above 1 million. How many cities can you name? With average growth rates nearing 16% and skyrocketing imports of US agricultural products, these explosive cities are re-drawing our map of China and redefining entry strategy in the 'world's largest market'. Taken together, China's Emerging City Markets tell a very compelling story: rapidly expanding middle classes, rising disposable incomes, and double-digit US food product import growth. The dynamic and untapped markets of China's 2nd tier economies are poised to drive the next economic miracle in one of the world's largest and most critical markets for US agriculture.

Includes PSD Changes: No
Includes Trade Matrix: No
Unscheduled Report
Beijing [CH1]
[CH]

Emerging City Markets - "The Next China"

Just five years after China's WTO entry in December 2001, savvy traders have already begun to look for 'the next China': a fresh, rapidly evolving market with newly affluent consumers eager for international products. From Vietnam to Brazil, India to Malaysia, economists, politicians, and consultants are all searching for the next big economic boom. Yet, behind the scenes in China's 2nd tier cities, the next economic miracle has already begun!

China's government has spent the last decade developing improved infrastructure in 2nd 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. Cultural, economic, and policy similarities mean that businesspeople can extrapolate the lessons learned in Guangzhou, Shanghai and Beijing and replicate the success of China's coastal mega-cities in Emerging City Markets like Dalian, Hangzhou, and Xiamen.

On the Map

Take a quick look at 14 Chinese cities with high potential: a geographically representative group distributed across China. Each city has a population in excess of one million, yet few Americans would recognize more than one or two of the names. Together, these 14 cities alone are home to more than 112 million: more residents than all of Canada, Australia, and the UK combined.

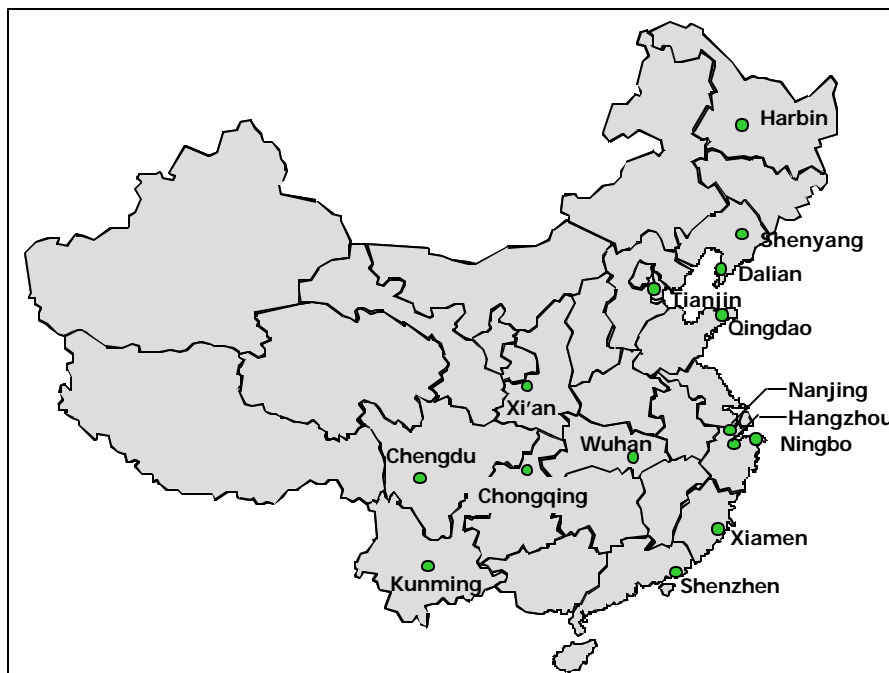
China is home to more than 100 cities with populations over 1 million¹ – cities like Harbin, a metropolis of 10 million residents in former Manchuria: hundreds of years of contact with Russia, Korea, and Japan make the region particularly receptive to new international culture, lifestyle, and food. Or, look south to

What is an 'Emerging City Market'?

The term 'emerging market' describes **newly recognized potential** for investment and business development. There is not a clear roadmap for working in these markets; however, they have high potential for growth.

Emerging City Markets (ECMs) can be defined as **2nd-tier cities**. Most are medium to large in size with strong growth trajectories, and employment, infrastructure, and policy conditions that encourage trade. Consultant Mark Sweeney compares ECMs to good art: they are hard to define, but **you will know one when you see one.**

This report focuses on a representative group of 14 ECM cities in China. FAS Beijing recognizes a strong pattern of unexplored emerging cities across China with extremely high potential as markets for US food and ag products.



¹ Red Herring Business and Technology Magazine, Jan 2007

Kunming, a fast-growing city of over 5 million people near China's southern border: an already diverse society made up of 26 of China's 56 ethnic groups, soon home to China's 4th largest airport and first railway connection with Singapore.

These cities are large enough to be on any map of China – and increasingly, their international transportation links place them firmly on the world map as well. Six of these fourteen cities are major seaports – seven, if we allow for the historical port city of Wuhan, located on the Yangtze river and accessible to large cargo ships. A massive surge of investment in infrastructure is producing new highways, railways, airports, and water links, predominantly outside the well-developed mega-cities. China's ever-growing highway system is expanding at a rate of nearly 2,000 miles each year². Already a global leader in railways with 43,750 miles³ of track, China is in the process of doubling track in order to separate passengers from freight – and will add 20,000 miles of track over the next decade. Nearly 50 new airports will be built in cities across China and dozens more will be renovated before 2010, bringing China's grand total to 190⁴. In fact, 13 of the 24 major transport infrastructure projects scheduled to begin in 2007 will take place in these ECM cities⁵.

Just How Big is this Market?

ECM cities are growing at a breathtaking rate: Qingdao, Dalian, and Ningbo all posting year on year growth rates of over 20% (see ECM Growth Rates, below)⁶. As a result, unprecedented numbers of urban Chinese are joining the ranks of the middle class. China's Academy of Social Sciences estimates that China's middle class currently makes up over 19% of the population nationwide, including a startling 49% of urban residents⁷. This means there are already 54 million newly affluent Chinese in these representative 14 cities alone – and McKinsey & Company estimates suggest China's middle class could reach nearly 300 million by the year 2011.

China's National Bureau of Statistics report urban disposable income grew more than 10% in 2006, reaching an average of US \$1,500 per capita⁸. These new urban residents are part of what McKinsey estimates as the youngest middle class in the world⁹, spending an average of 39% of their disposable income on eating. As a rule, they're much more adventurous than their parents' generation when it comes to sampling and paying for new to market and imported products.

Emerging City Markets

	<i>Population (millions)</i>	
1	Chongqing	31.44
2	Harbin	9.7
3	Tianjin	9.3
4	Wuhan	7.86
5	Qingdao	7.31
6	Xi'an	7.25
7	Shenyang	6.94
8	Hangzhou	6.52
9	Nanjing	5.84
10	Dalian	5.61
11	Ningbo	5.53
12	Kunming	5.03
13	Shenzhen	1.65
14	Xiamen	1.47
	Total	111.45

² US Department of Commerce

³ The Sunday Times, March 4, 2007

⁴ China Daily, 2006

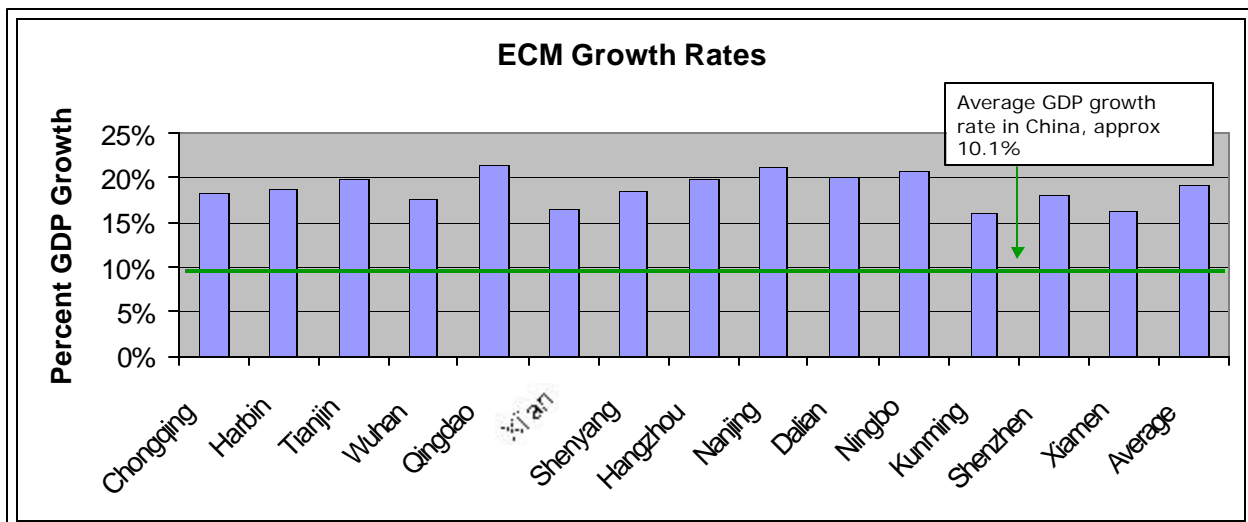
⁵ China Daily, 2007

⁶ China Statistical Yearbook, 2005

⁷ China Daily, 2005

⁸ People's Daily, 2007

⁹ McKinsey Quarterly, 2006



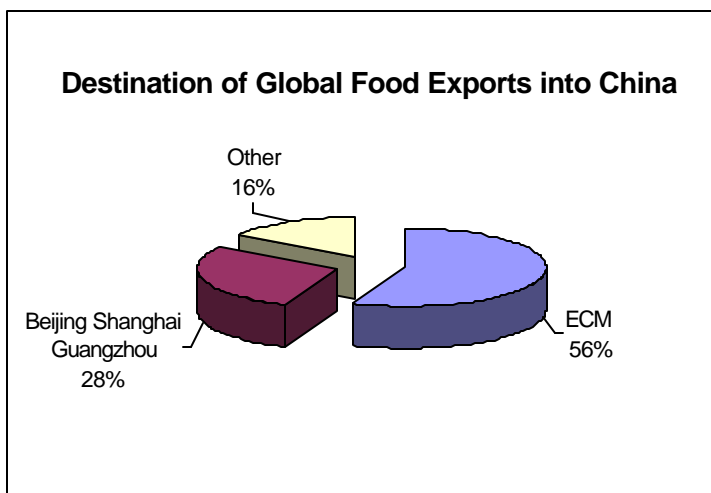
Source: National Bureau of Statistics China Statistical Yearbook 2006

A New Landscape

Supermarkets and department stores are joining high-end restaurants and hotels in expanding to China's ECMs. American retailer Wal-Mart, for example, has all but bypassed mega-cities Beijing, Shanghai, and Guangzhou, locating 44 of their 47 new superstores in China's ECMs¹⁰. An evolving understanding of food safety in ECMs and the relative absence of international-level competition outside of mega-cities have made this market particularly attractive for retail supermarket entry, evidenced by retail development in ECMs.

Driven by changing perceptions of what constitutes 'quality' food, retail groceries appeal strongly to middle-class and wealthy customers in ECMs. Traditionally, Chinese shop at local 'wet markets' for everything from spinach to live fish to basics like sugar and flour. Although these markets deliver very fresh products, they often tend to be chaotic, inconsistent, and visibly lacking in refrigeration and sanitary measures. Customers in ECMs increasingly prefer clean and convenient supermarkets that provide a higher measure of food safety, certification, and labeling information. In recent years, ATOs have successfully assisted distributors of US products with retail promotions of new-to-market and other US food products in a number of supermarkets in ECMs around China.

In addition, many chained restaurants as well as independent, high-end dining establishments have a strong and growing presence in China's ECMs. Well-established players like KFC and McDonalds are already looking to 'third-tier' cities, considering reduced franchising fees in order to encourage expansion. Meanwhile, upscale dining venues have been incredibly well received in ECMs, as wealthy couples, businesspeople, and government officials enjoy an increasingly diverse mix of international



¹⁰ Wal-Mart China Website, www.wal-martchina.com

and regional cuisine. And, cozy cafés serving western food, coffee, and dessert along with free wireless internet are full to overflowing near universities and business districts.

As a result of these growing retail and food service markets in ECMs, the landscape of international foods exported to and consumed in China is also shifting. Beijing, Shanghai, and Guangzhou still import around 28% of all US food products entering China, however, China Customs data shows that in 2006, our group of 14 fabulous ECMs described above imported more than 56% of all US food products destined for the China market!

Targeting Emerging City Markets

More Demand, Less Competition

China's ECM cities are filled with consumers often having their first experience with imported food and agricultural products. These markets are less saturated than coastal mega-cities, translating into fewer competitors for eager consumers who often associate US products with quality and upward mobility. Conversely, consumers in coastal mega-cities have already been exposed to an increasingly wide range of high-quality imported foods for over a decade. Demand for imported food is beginning to plateau among Beijing, Shanghai, and Guangzhou consumers who know exactly what they want and have ready access to a wide range of global brands.



Shoppers in a new supermarket, Kunming

This pattern is reflected in prevailing market trends: over the last two years, US food product exports to the highly saturated markets in Guangzhou and Shanghai actually fell by 35% and 12%, respectively. During the same period, Tianjin bought 24% more US food products, Dalian saw a 32% increase, and Hangzhou went from importing around US \$86 million to over US \$142 million in food products, a whopping 65% surge¹¹. China's market is evolving very rapidly, particularly Emerging City Markets.

Lower Costs

Cost of doing business in Beijing, Shanghai, and Guangzhou is as high as any international city. Mercer's annual Cost of Living survey ranks Beijing and Shanghai among the 20 most expensive cities in the world in 2006¹². These high prices drives up costs: staff salaries, retail floor space, and advertising. ECM cities can be a markedly less expensive place to do business. Additionally, local businesses in ECMs are often eager for their first international contacts, and will prioritize the business ventures of such partners highly.

Policy Support

As part of the campaign to develop central China, every level of the Chinese government is implementing policies geared towards increasing international business, with a focus on ECM cities: The mayor of Dalian is currently campaigning to make the city's new port the first Free Trade Port in China, sweeping trade incentives have been introduced in Shenzhen, and the Central government has invested more than US \$100 billion to build airports, highways, railroads, and ports in recent years¹³. Such policies have been instrumental in decreasing the cost of doing business in ECMs while increasing opportunities in these cities.

¹¹ World Trade Atlas, China Customs Data 2004-2006 for Imports from the US by District for Product Group "Food Products"

¹² Mercer Human Resources Consulting

¹³ PRC Ministry of Commerce, 2006

The Long Term

Entrée, experience, and exposure in China's Emerging Markets

China is increasingly becoming urban and affluent, and the Chinese Academy of Social Sciences estimates 40% of China's total population of 1.5 billion will be considered 'middle class' by 2020¹⁴. Most of that population does not live in Beijing, Shanghai, and Guangzhou.

ECMs represent not only a viable market for US agricultural products in the near term, but also provide access to and experience in the vast inland markets projected to undergo transformation from hinterland to heartland over the next two decades in China.

Snapshots

A quick look at three of the 14 cities focused on in this report

Xi'an

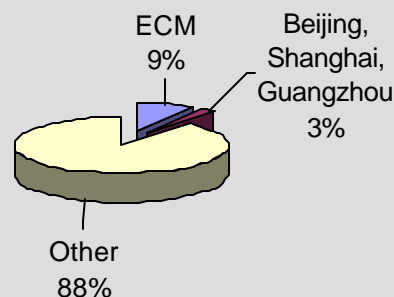
Xi'an is a city of over 7 million and is the capital of western China's Shaanxi Province. The site of China's imperial capital through 13 dynasties, Xi'an and the surrounding area is home to many must-see historical and World Heritage cultural sites, driving a bustling and well-established tourist industry. Xi'an is the most developed city in its region, and has benefited significantly from the government's recent emphasis on economic development in central and western China. In addition to the tourism economy, the city is highly industrialized, and a well-heeled group of entrepreneurs, managers, and investors frequent the city's fine dining establishments for working lunches and business banquets.

Kunming

Kunming, a city of 5 million residents, is the capital of southwestern Yunnan Province. The province's economy has traditionally depended on mineral and timber resources, but in the last decade, a thriving domestic and international tourism industry has developed. Drawn by natural scenery, cultural diversity, and arguably the best golf course in Asia, the province is one of China's top tourist destinations and draws well over 50 million visitors annually. The medium-sized international airport is quickly becoming overburdened; and a large new airport is currently under construction. Ethnic diversity, foreign tourism, and proximity to international borders means Kunming residents have ample exposure to exotic cuisine. Kunming's place as a corporate vacation hotspot has contributed to the rise of a number of high-end Chinese and international restaurants, often proximate to the city's 17 four and

Where is China's Market?

China's Population Distribution



A quick glance at the above chart reveals a startling truth: only about 3% of China's population lives in Beijing, Shanghai, and Guangzhou, yet these cities are driving a global frenzy to do business in China!

The 14 ECMs focused on in this report account for an additional 9%. This means the remaining **88% of China's population are a virtually untouched class of potential consumers**. And, nearly half of them will enter China's middle class within 15 years.

¹⁴ China Daily, 2005

five-star hotels. In addition, retailers Wal-Mart, Metro, and Carrefour all have established a presence here with surprisingly little local competition.

Xiamen

With a population of 1.5 million, this vibrant port city was one of the first in China to be declared a "Special Economic Zone" and today receives nearly 1 million international business travelers each year. Located on the mainland side of the Taiwan Straits, the region's strong historical, cultural, and linguistic ties with Taiwan have spurred investment and development. Many international companies like *Dell*, *Kodak*, and *Siemens* have established a presence here. International retailers have also entered the market and are popular, particularly with customers who drive cars and appreciate the convenience of parking available at these outlets. The temperate climate, good quality of life, and proximity to one of China's largest ports makes Xiamen one of the best places to do business in China.

For more information

See USDA China's continuing series of GAIN reports focusing on individual ECMs. These are available online at www.fas.usda.gov under attaché reports for China. Recent reports include the following:

Xi'An March 30 2007	pending
Xiamen Jan. 30 2007	CH7603
Qingdao Aug. 16 2006	CH6414
Shenyang July 10 2006	CH6407
Harbin March 24 2006	CH6406
Chengdu Jan. 12 2006	CH6801
Wuxi Jan. 6 2006	CH5829
Hangzhou Dec. 9 2005	CH5827
Dalian Nov. 9 2005	CH5414
Chongqing Oct 14 2005	CH5818
Shenzhen April 27 2005	CH5606
Yangzhou March 8 2005	CH5806

Stay Tuned: Regular Emerging City Market (ECM) updates and city profiles are added throughout the year.

Contact Us

For further information on China's Emerging City Markets, as well as our upcoming events and activities, please visit our web site at www.usdachina.org or contact one of the Agricultural Trade Offices directly:

Agricultural Trade Office, Beijing

Kerry Center, South Tower
24th Floor Suite #2425
No. 1 Guanghua Lu, Beijing 100020
Phone: (8610) 8529-6418
Fax: (8610) 8529-6692
E-mail: atobeijing@usda.gov

ATO Shanghai: atoshanghai@usda.gov

ATO Guangzhou: atoguangzhou@usda.gov

ATO Chengdu: Opening June 2007