



# Chinese food distribution and retail outlets

**Exporting food to China**

**March 2016**





**The Exporting Food to China report series** is published by Australian Centre for Sustainable Business and Development, Agricultural Value Chains team. Read together, the reports serve as a valuable decision support tool that covers the full length value chain journey. Packaged beef from Queensland is used as an example in the reports. However, the principles discussed will be relevant to decision makers in most agricultural export industries. The series provides essential information for Australian businesses looking to enter the lucrative Chinese market.

The Australian Centre for Sustainable Business and Development (ACSBD) is a research centre of the University of Southern Queensland, Toowoomba, Queensland, Australia.

The ACSBD Agricultural Value Chains team is led by Professor Alice Woodhead. The team works with local and national industries to better understand critical infrastructure, product development and export opportunities, risks, pathways and consumer purchasing preferences.

The value chain research is founded in systems thinking. This enables the team to make sense of the complexity and emerging issues that define our agricultural and food systems and export markets.

The team works closely with a broad range of stakeholders with the aim of developing targeted and practical strategies and decision support material.

#### Project and steering committee

The project 'Facilitating the transformation of Queensland's agricultural value chains' is funded by Queensland Government and University of Southern Queensland.

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## Introduction

This report is part of a series on the export of Australian food to China. The purpose of this report is to review the distribution supply chain system for the export of food to China. This report describes the product flow and stakeholders in the chain, characteristics of the chain, relationships between suppliers and customers, cold chain logistics systems, and risks associated with the supply chain.

This report is supported by the others in the series. Considered together, these reports provide a picture of the supply chain from Australian farm gates to Chinese consumers. Developing a greater understanding in this area will enable new and expanding exporters to take the best possible advantage of the Asian food boom.



## Characteristics of Chinese distribution systems

The Chinese food distribution system has evolved from a traditional planned economic system to a mix with western market systems. Due to its unique social, economic and political system, the Chinese distribution differs in many ways from western supply chains.

### *Lack of specialization and differentiation*

There are relatively few specialized and dedicated wholesalers. Once a product shows strong demand and the potential for profit, everyone rushes to sell the same item. Many wholesalers end up selling the same product competing based on price. There is little product differentiation and wholesalers operate on low margins because of price-based competition.

### *Producers and food processors involved in wholesaling and retailing*

According to Li and Fung (2006), producers tend to bypass wholesalers to sell their own products directly to the market and retailers bypass wholesalers to source their own goods because many businesses believe that minimal layers of circulation of their goods and products can increase efficiency, reduce transaction costs and increase margins.

With China's improving logistics infrastructure, some established brand owners and manufacturers have set up their own wholesale and retail facilities. Indeed, these enterprises view distributing their own products as an effective means of keeping abreast of the latest market developments.

Many food processors set up their own wholesale and retail teams to conduct wholesaling activities. Many individual farmers or groups of farmers also conduct wholesale operations in their local wholesale markets. The low cost of labour

makes it relatively inexpensive for farmers and food processors to work further down the supply chain, especially when price is the main basis for competition.

*Many wholesalers function as both wholesalers and retailers*

It is very difficult to estimate the exact number of wholesale markets in China, at least each Chinese city has one with more than two in first and second tier cities. In many of these wholesale markets, firms act as both wholesalers and retailers. Officially, businesses need to have different licenses for conducting retailing or wholesaling as can be seen from Chinese statistical reports, but at a practical and local level there is not always a clear distinction between a retailer and a wholesaler.

To understand this phenomenon, it is necessary to understand the function of Chinese wholesalers and its difference to that of western countries. In western countries, the wholesaler is defined as a professional agent or trader who deals with other professionals rather than the public. They may supply retail stores or street markets, or sometimes engage in exports. Their function is to offer a wide variety of products to a diverse range of customers based on segmentation (Spielrein 2003).

Stern et al (1996) explain that direct contacts between retailers and producers are not considered profitable due to their inefficiency. In order to reduce costs and save time, wholesalers are preferred in theory and used in practice. Through one wholesaler, several producers and retailers can be connected. Instead of dealing with several producers, retailers can obtain products from one wholesaler, thus reducing transaction costs.

The same theory, however, does not apply to China's situation. This is because wholesale markets lack specialization and differentiation, and labour is available and cheap enough to be used to maintain multiple connections, some directly, between retailers and producers. As a result, many wholesalers in China like to function as both wholesalers and retailers to make as much profit as possible.

Some consumers, particularly middle and low income earners, prefer to shop at wholesale markets to get the lowest prices. Spending time shopping has no opportunity cost for them; their goal is to save as much money as possible.

In western countries, the "all-products" wholesaler does not seem to have much of a future (Spielrein 2003). In Chinese wholesale markets, "all-products" wholesalers are continuing to prosper driven by the demand of end consumers.

In recent years, some large-scale wholesale markets have upgraded themselves with effective management, modernised facilities and better brand positioning. It is widely expected that China's wholesale markets will continue to be a highly significant distribution channel. However, wholesale markets are often viewed as disorganised, selling low-end and unbranded products.

### *Many retailers prefer direct dealing with producers*

Many Chinese retailers prefer dealing directly with producers in order to receive better purchasing conditions, such as lower prices and better quality, and also to bypass the middleman. These direct connections with producers also have communication advantages (Qiang and Harris 1990), and in some fields such as frozen food and fresh vegetables, direct deliveries are common.

### *Warehouse-style supermarkets*

Warehouse-style supermarkets have become another effective channel to distribute products on the mainland. Sam's Club, a division of Wal-Mart Stores, is a typical example. It adopts a membership system and sells goods in bulk at wholesale prices to its members, with both enterprises and individuals welcome to participate.

### *Online distribution*

Online distribution is increasing rapidly including Business to consumers (B2C) and business to business (B to B). Many retailers have opened online shops on B2C platforms to widen their customer reach or for more effective promotion. However, most platform operators are actually online transaction facilitators that do not engage in real distribution businesses; they charge suppliers membership fees for listing on their websites and do not involve themselves in the actual businesses they show. An increasing number of wholesale markets (among the more traditional channels), have also built an online presence (B to B). Despite rapid growth over recent years, online distribution in China is not without its challenges. Many buyers are still reluctant to place large orders online, with the threat of possible fraudulent activities and credit defaults.

### *No vertical and horizontal integration in the distribution channel*

Boyle et al (1992) have defined four vertical marketing channel types with varying degrees of integration: corporate, franchised, aligned and market systems. Corporate systems are the most integrated and market systems are the most loosely connected. In China there are very little vertical and horizontal integration in the distribution channels. In other words, firms in the channel are quite independent to each other.

### *Lack of market regulation and the weak legal system*

In western countries, most integration is based on some kind of contractual agreement. The lack of regulation, weak laws and poor enforcement in China make successful co-operation very dependent on personal relationships.

### *Prevalence of counterfeit products*

Many wholesale markets in China sell a large number of counterfeit goods, which has affected buyers' confidence.

In general, the above characteristics of supply chain in China encourage profit-taking through opportunism, and as a result they present very significant barriers and obstacles for effective supply chain management.

## Import sector

The landside import sector functions as customs clearance. It is normally processed by importers or import agents. The flow chart of the process of import customs clearance is illustrated in Figure 1.

This sector includes three types of importers:

- **Specialized meat importers and agents** whose responsibility is to facilitate import documents preparation and handling. These are often used by wholesalers or distributors who do not have meat import licenses.
- **Wholesalers, hypermarket and cooperatives** who have meat import licenses and import meat to service their own businesses.
- **Meat processors or abattoirs** who have import licenses. They often import whole carcass or semi cut for further processing according to their customer specifications. There are two types of processors and abattoirs according to the nature of firm's ownership: state-owned and private owned. Private firm are more flexible than state owned in term of business operation and management in order to meet customer requirement. Meat processors normally have their own marketing teams and distribution channels reaching to various retail outlets. Some even have established their own franchised retail shops.

To reduce customs clearance times, certain companies can make a customs declaration in advance and present the documents after the goods are dispatched or before their arrival or in the 3 days which follow the arrival of the goods in a customs surveillance zone. The description, specification and quantity of import of goods must be determined in advance. Customs will examine the goods directly and will release the goods. The level of flexibility depends on the relationships between importers and custom officials.

The declaration can be done via the customs site, by indicating the place of arrival of the goods, as well as all the customs data. Once the data is analysed by the customs, a receipt will be sent, so that the company can complete the shipping of goods. Custom duties are then paid by bank transfer.

Documents to be presented to customs vary according to the products. However, there are standard documents to be presented: the bill of lading, the invoice, the packing list, the customs declaration, the insurance policy, the sale contract, the inspection certificate issued by the AQSIQ(General Administration of the PRC for Quality Supervision, Inspection, and Quarantine) and other licenses of safety and quality.

If the imported goods are found to have complied with Chinese import requirement, they will be released by CIQ (China Inspection and Quarantine Service). If the imported goods are found not fully complying with China's import standards, they will be rejected. If that is the case, additional time and storage costs will be incurred as the Chinese customs stores your

products until importers provide the documents needed. In the worst case, the goods might be demolished or sent back. For food items which cannot meet quarantine and phytosanitary requirements, further treatment could be required to pass inspection. Exporters have the option to divert the goods to other, less restrictive countries.

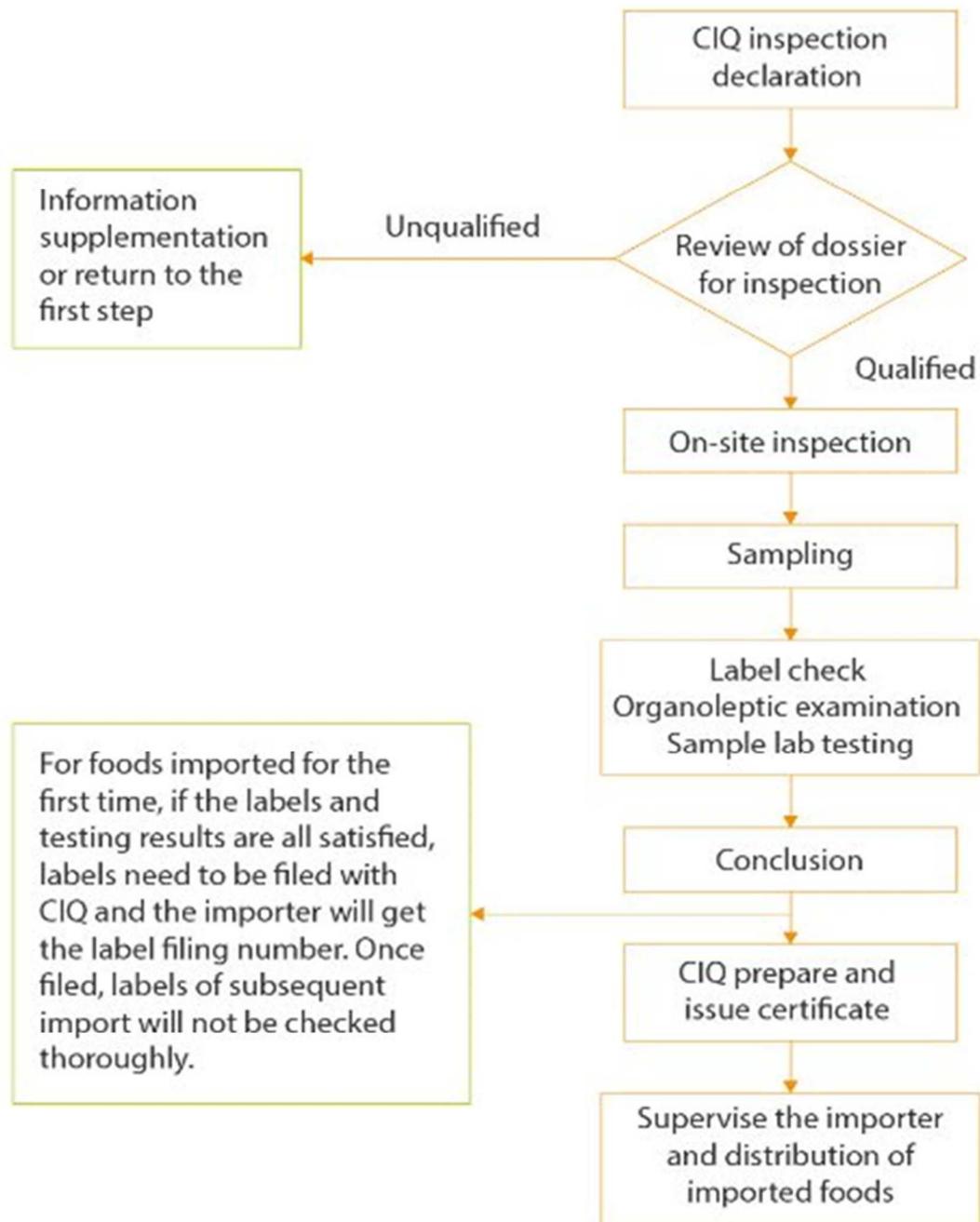


Figure 1: Flowchart of Chinese customer clearance

All imported pre-packaged food must be labelled in Chinese (simplified Chinese as used in mainland China). In addition to Chinese characters, English and other foreign languages may also be used.

CIQ requirements often change and can be complex to interpret. Australian exporters need to consult with their Chinese importers to re-confirm labelling requirements and other product certification prior to dispatch of goods. An effective method is to take photos of the package as well as the label details of products and arrange for the importer to have CIQ preview them before shipping.

### **Wholesale (Intermediary trade) sector**

The second sector of the beef chain is the wholesale market or intermediary trade, an area conducting business to business marketing and distribution. This sector involves three types of firms:

- **Wholesalers** who function as agents on behalf of importers. They do not take responsibility for delivery. They do not own the product they are selling and only take commission from importers;
- **Wholesalers/distributors** who have the ownership of the products they are selling and provide service for delivery if requested; and
- **Distributors** who provide storage and delivery service to importers, wholesalers or retailers.

Wholesale markets have played a significant role in the distribution system. In the late 1980s and 1990s, merchants began to congregate in various locations to sell branded and similar products. A decade or two later, some cities have become famous for certain products. Such focused channels serve as distribution points for small- and medium-sized manufacturers, allowing them greater access to China's urban consumers.

Wholesale markets in China are generally small and fragmented compared with those of developed countries, a corollary to China's millions of small and geographically dispersed retailers. This makes the distribution of most goods physically and financially difficult. Inadequate cold chain facilities further compound this problem. For people living in tier two or three cities, products have to go through three levels of wholesale markets before reaching them.

### **Retail sector**

China's retail sector is evolving to accommodate a landscape where consumers demand better quality and unique products and services. This is particularly true in the food retail sector where quality and safety issues are a major concern. At the same time, technology innovations and improved logistic systems are driving retail sector into more diversified way of running business. Gleaming 100,000-square-foot hypermarkets coexist with traditional outdoor wet markets and online shopping, each catering to the needs of different consumer segments.

The key aspects of this transformation in the Chinese retail sector are described by Fung Business Intelligence Centre (2013):

- Aggressive store expansion is replaced by improving store productivity;
- Retailers launch their own private labels or proprietary brands;
- Mobile-commerce is increasingly popular, as is mobile payment;
- Digital marketing is ever more prevalent;
- Improving customer relationship management;
- A multichannel approach to sales such as online and offline integration;
- Tier 3 and tier 4 cities become the development focus;
- Mergers and acquisitions continues to be an attractive avenue fueling growth;
- Retail sales are primarily driven by the urban population (86.5%) and rural retail sales grew at a faster pace; and
- Luxury market slows as anti-gift regulations take root.

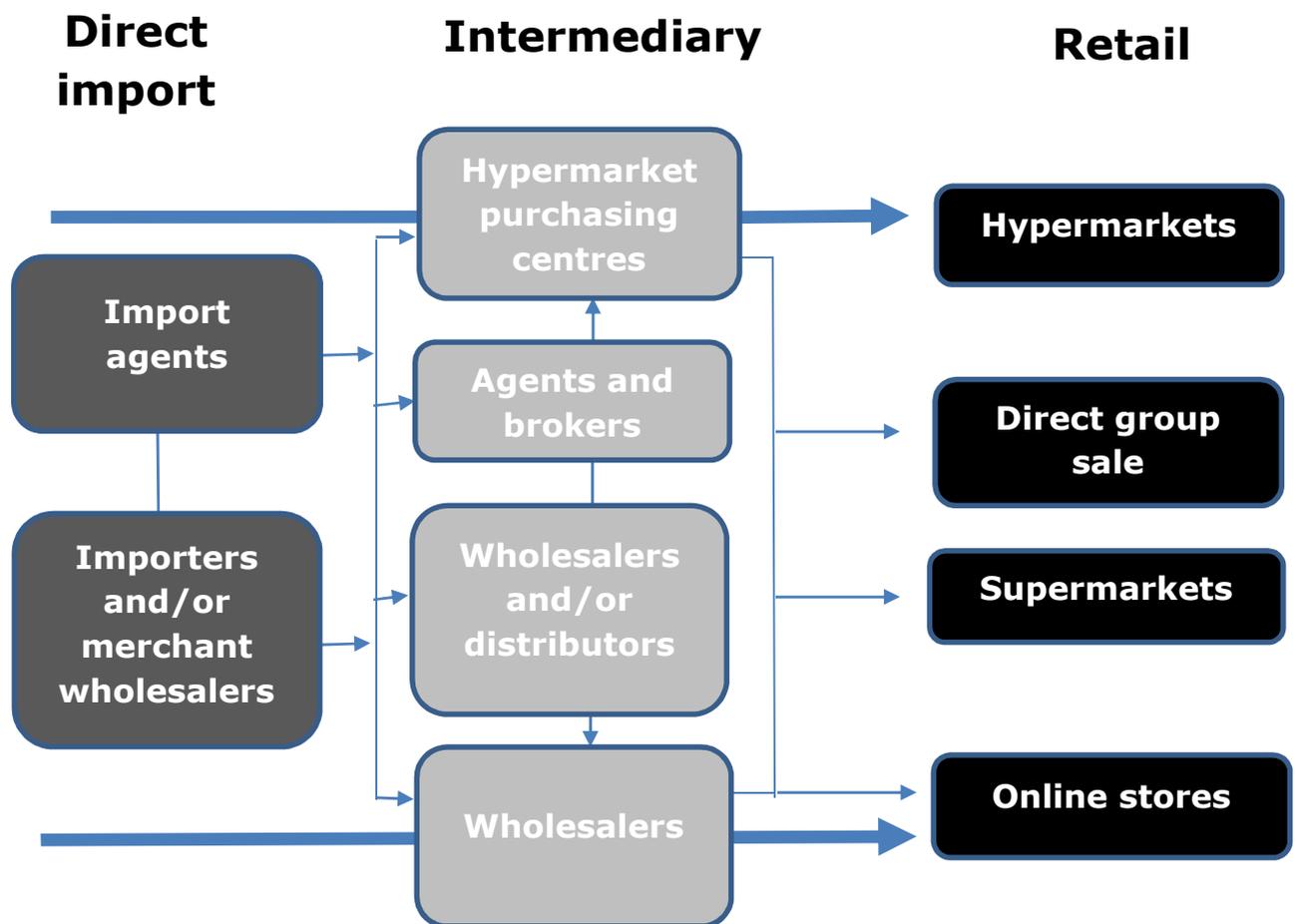


Figure 2: Distribution system flow chart

Although there are many types of retail in China, they can be classified into 4 categories:

- E-retail outlets including Business to Business, Business to Consumers and Consumers to Consumers;
- Off-line retail outlets including hyper markets chain shops, supermarkets, stores & shops, wet markets and high-end supermarkets;
- Hospitality retail outlets including Restaurants, hotels and Clubs; and
- Direct selling to groups including cooperatives, government organizations, international organizations/firms and Chinese private firms.

### *E-retail outlets*

Chinese e-commerce has is growing exponentially. Online retail sales in 2004 grew 50 percent to reach half a trillion Australian dollars. The key drivers behind on-line business flourishing in China are:

- Heavy traffic problem in most large cities - people use online purchase to cut their shopping time;
- cheap online retail prices of many goods, particularly counterfeited brands;
- manufacturers choosing online sales to shorten the supply chain - this allows for lower retail prices than selling through physical shops;
- The initial cost of setting up an online business is much less than setting up a physical retail shop, creating an easy entry for most small business;
- The pervasiveness of technology makes online shopping much easier and more convenience. Integrating online shopping systems with mobile devices lets consumers to buy at any time and allows for more communication with sellers; and
- Online stores lack the geographical limitation of traditional physical shops - this permits a broader range of customers.

There are two types of online retail sites: business to consumer (B to C) and consumer to consumer (C to C).

B to C involves firms selling directly to consumers by using ecommerce platforms, a series of software technologies that allows interested merchants to build and host a digital storefront to sell their products or services.

In China there are three major companies providing online platform services: Tmall, Taobao, and JD. They account for more than 90% of the total e-commerce market in China and receive over 100 million daily visitors. However, new e-commerce platforms such as YHD.com and VIP.com are steadily gaining market share. Many smaller e-commerce platforms are launched each year, however these new platforms are risky and often short-lived.

According to Duco ([2014](#)), Taobao is an online marketplace where anyone can sell their products, both consumers and businesses. In contrast, sister-website

Tmall is strictly for businesses, and allows only brand-owners and official licensees to sell products through the platform.

Taobao is mainly price-driven with thousands of local small businesses and consumers in competition. Tmall is more brand-driven and a popular gateway for foreign companies to enter the Chinese e-commerce market.

Tmall is relatively expensive and will require a considerably higher initial investment than when opting to sell on Taobao. It is therefore important to first understand who you are targeting, what your long-term goals are and how important branding is for your products (Duco, 2014).

JD is direct competitor of Tmall. JD differentiates itself by focusing on developing its own distribution system including automated warehouse, seven fulfillment centers, and last-mile delivery networks throughout China. In contrast Taobao and Tmall rely heavily on third-party providers. JD can provide three hours delivery in most tier 1 and 2 cities, same day delivery in 134 counties and next day delivery in 866 counties and districts. JD Worldwide also includes a partnership with eBay that will allow selected vendors on the auction/e-commerce site to sell directly to Chinese consumers.

In 2015 both JD and Tmall launched a new worldwide sales platform which enables overseas vendors to sell directly to Chinese consumers without having to set up business locally. JD Worldwide will be integrated with JD.com and launch with 450 online shops carrying 150,000 products. Customers who order goods through JD Worldwide will have their items delivered to them from overseas inventories through JD.com's in-house logistics infrastructure.

### *Consumer to Consumer (C to C)*

Traditional Consumer to Consumer electronic commerce involves transactions between consumers facilitated online by a third party. A common example is the online auction, in which a consumer posts an item for sale and other consumers bid to purchase it; the third party generally charges a flat fee or commission. The sites are only intermediaries, just there to match buyers and sellers. They do not have to check quality of the products being offered. Taobao is a C2C site analogous to e-bay, and was created by Alibaba in 2003. Sellers are able to post new and used goods for sale or resale on the Taobao Marketplace, either at a fixed price or by auction.

Chinese C to C is evolving with the strong influence from social media. China's social media platforms have become an important additional driver or facilitator of e-commerce activity. These platforms, such as WeChat or Sina Weibo (China's leading Twitter-style microblogging platform) have been growing rapidly. With almost instantaneous feedback and easy-to-use interfaces, social media platforms have become a staple in the life of Chinese e-consumers. Consumers in China use these platforms to sell products to their social media groups. On the other hand purchasers can get immediate 'buy/don't buy' advice from friends, post product reviews, seek product knowledge/advice from key opinion leaders.

Given the negligible cost of setting up C to C business through social media platform, many Chinese are venturing into C to C selling.

To accommodate these changes, social media platforms are integrating with the e-commerce chain and retailers are developing a more sophisticated social media presence, and some social media platforms. In a recent example, WeChat have added payment functionality allowing users can make purchases directly from the application. Such trends are fostering an environment where mobile devices are becoming an increasingly crucial element in China's e-commerce arena.

In terms of food e-commerce, there are many specialty marketplace selling online imported food in major Chinese cities. These providers often can provide better cool chain service in delivery. However the cost of delivery is expensive.

### **Off-line retail outlets**

Off-line retail outlets include wet markets, hypermarkets, supermarkets, convenience stores and high end retail shops.

#### *Wet Markets*

Wet markets contains mostly food items and are associated with having wet floors. The wet floors ensure that the food does not spoil fast. There are also no set prices in wet markets and the vendors are open to bargaining. Wet markets are the traditional outlet for people to purchase fresh and perishable food products, including vegetables, meats and fruits. Some processed and semi-processed food products are also available in wet markets. The majority of middle and low income people use wet markets as the main source for purchasing their daily food items, particularly fresh produce. The prices in the wet market are usually cheaper than the supermarket due to the low cost of maintenance.

Morning wet markets (MWM) are popular in China and exists in almost every city in China. These markets is operate in the early morning along dedicated streets designated by local government in the residential area. Large cities often have many MWM located in different districts. Most urban residents purchase their vegetables, meats and fruits from MWM due to convenience (closeness), low prices and freshness.

#### *Hypermarkets & Supermarkets*

Hypermarket and supermarket chains have been developing rapidly since 2000. The China Chain Store & Franchise Association (CCFA) is the official representative of the retail & franchise industry in China. There are more than 1,000 enterprise members with over 300,000 outlets in 2013 including domestic & foreign-invested retailers and franchisers and relevant organizations. According to CCFA, the top 100 retail chains shared 9% of the national sales in 2012. According to the CCFA, the 100 chains in tier 3 and tier 4 cities have

developed and expanded faster than in tier 1 and tier 2 cities, mainly due to relatively saturated retail markets.

Most supermarket chain shops are large self-service grocery stores that offer customers a variety of foods and household supplies. Some chain shops offer free shuttle bus services to attract customers.

Hypermarkets (a combined supermarket and department store) have a reputation for offering high-quality products that appeal to affluent urban Chinese who are concerned with food safety issues. They generally offer more imported products than domestic supermarkets. International hypermarket retailers in China are more receptive to imported products as they are more familiar with them. Hypermarkets usually have a small group of preferred distributors they deal with; exporters looking to get their products onto the shelves in hypermarkets should focus on these select few distributors. Foreign retailers have performed far more strongly in the hypermarket channel than any other retail channel. Major hypermarket players are Carrefour, Wal-Mart, Metro, Lotus, Auchan, and Tesco.

This channel is quite fragmented as there are large numbers of small regional chains or independent supermarkets, especially in many second and third-tier cities. Imported food is less prominent in Chinese supermarkets. Products that do well in this sector tend to be commodity products already widely available, such as fresh fruit and frozen vegetables. Supermarkets seldom import directly, or even buy directly from an importer. Instead they usually rely on wholesale markets and local manufacturers or distributors.

#### *Convenience Stores*

This is the least developed channel, but has lots of potential for growth. State-owned domestic retailers have tended to dominate this channel.

#### *High-end retailers*

High-end retailers include specialty Supermarket Stores and Boutique Stores. These types of stores are often located near high-end department stores and fashionable business centers. They generally have a high proportion of imported food products – ranging from 10 to 80 percent of their product range. Specialty supermarkets are not only present in first-tier cities, but also some second-tier ones. Major specialty supermarket players are City Shop Supermarket (Shanghai), City-Super, CRV Ole, BHG (Beijing Hualian Supermarket), Hisense Plaza in Qingdao, and Jin Bou Da in Zhengzhou. High-end retailers are in the earlier stages of entry into China, mainly focusing on selling luxury goods to Chinese consumers who are seeking authentic products with reputable brands.

#### *Hospitality retail outlets*

According to Euromonitor ([2013](#)), the Chinese foodservice sector was worth \$367 billion in 2011, and it is expected to grow to \$495 billion by 2015.

According to the ANZ Agribusiness report (2013), dining out has become more

and more popular across China, particularly in big cities. City dwellers, especially young people, frequently consume fast food or convenience food for breakfast or lunch, due to the quickening pace of life. A faster pace of life, higher living standards, increasing disposable incomes, as well as the faster development of the restaurant sector have made dining in a restaurant an affordable social event for gatherings with family, friends and business contacts. Full-service restaurants dominate the foodservice landscape, with a market share of around 72 percent, followed by fast food restaurants at around 25 percent. However, the Chinese foodservice sector is extremely fragmented. Western-style restaurants account for only 1 percent of the market, and tend to be concentrated in the coastal cities. Fast-food restaurants account for approximately 23 percent of this market. The main players are: Yum! Foods (KFC, Pizza Hut), McDonalds, and Dicos (a Texas fast-food chain).

According to ANZ Agribusiness report (2013), foodservice is a key player in introducing imported foods. High-end restaurants and hotels are less constrained by price considerations and more interested in presenting unique dishes and products. If successful, their efforts are likely to be copied by other restaurants, bringing them closer to mainstream middle-class consumers. It is important to note that while the sector as a whole has great potential, many parts are not strong candidates for imported foods. Catering operations that run cafeterias and provide box lunches, as well as small family-owned restaurants, account for a large proportion of the industry, but are price-sensitive

China's hotel industry has experienced dramatic growth, resulting a \$4.4 billion business with 2.5 million hotel rooms (Goh et al 2013). The high-end 4 & 5 star hotels cater most of international travelers and provide western style dishes for both Chinese and international guests. With the increase in the number of high end hotel market, the demand for imported cooking ingredients are increasing.

Clubs are places visited often by Chinese wealthy people for exploring business opportunities and developing business relationship. The total number of clubs in China is unknown. However there is more than 10000 in Beijing alone in 2009 ([www.yoka.com/dna/d/50/102.html](http://www.yoka.com/dna/d/50/102.html)). Many of these clubs include food catering function, providing high quality food items such as imported wines, fruits and meat dishes.

### *Direct Selling*

There are thousands of government organizations, international/private organizations, firms and cooperatives located at cities such as Beijing, Shanghai and Guangzhou. These organizations and firms often purchase goods and service directly from manufactures or wholesalers in a large volume and then distribute to their staff and workers.

In China, it is very common for government organizations and state owned firms to provide consumable goods to their staff and works before New Year, Chinese spring festival, labor days, Chinese moon festival and Chinese national day.

These are considered to be fringe benefits of employment. Sometimes staff and worker are asked to pay symbolically, usually only a fraction of the purchase price. Food products such as wine, cooking oil and fruit are common selections.

## **Relationships between suppliers and customers in the chain**

Marketing reforms have led firms to increasing development of co-operation and collaboration. The supply chain system is currently in a state of transition, with varying degrees of types of cooperation in the supply chain. Four kinds of relationship can be identified.

### **Arms-length relationships**

Arms-length relationships mean that suppliers and customers are independent of each other and no party has power over the other. Suppliers and customers seek to maximize their own benefits, even if it means sacrificing the interests of other parties or the whole distribution channel. Constant bargaining occurs between suppliers and customers, and this is the most common type of relationship in Chinese food supply chains.

This type of relationship is characterized by little investment, little information sharing and limited interaction between companies. Trust and commitment are low. Relationships at this stage are short-term, contract-based and adversarial, with several suppliers competing on price as the overriding factor. At this level, companies can easily change partners and efficiently perform routine tasks.

Arms-length relationships are frequent among Chinese firms of small and medium size, which number 8 million and collectively account for 99 percent of the country's total enterprises. Searching for best price and lowest transaction cost is the goal for most of these firms. In other words, customers are continually searching for the cheapest suppliers while suppliers search for firms who can offer the highest price. This searching effort has become one of the most effective ways for those firms to enhance their position and to have more bargaining power in the distribution chain.

Arms-length relationships give firms the ability to remain independent and easily controlled. Most Chinese firms see arms-length relationships as suitable to them; they have no long term plans because of the uncertainty they feel. These relationships are also a way for a new firm to enter a market where it has no reputation, low distribution ability and low financial capacity.

### **Co-existing relationships**

Co-existing relationships involve medium to large firms working together to distribute their products, typically to a new region where co-operation with local wholesalers and retailers is necessary. Using established distribution networks of local distributors, these firms can quickly open a new market or increase their

local market share. However, for a reputable distributor to be willing to cooperate, these firms have to guarantee the distributor's profit. Suppliers may work together with their customers and be willing to share information. Power in the chain is more equally distributed, but firms can still work independently on short-term initiatives.

### **Dependent relationships**

This kind of relationship often involves medium and large sized firms, including the larger state-owned enterprises. Such firms have greater power because of their size/capacity, brand, reputation, technology, market share or market control. This dominance is exerted over other firms who have to adjust to meet the requirements of these leading firms. The advantage of this type of relationship is that the inefficiency caused by conflict between firms is less because of the dependence in the relationship. Larger companies can develop co-operation mechanisms with less effort as the dependent firms have to accept the larger firm's leadership.

Compared with the first two types of relationship, leadership-based relationships are more stable and the basis of cooperation is clearly identified. Both sides have to consider the interests of their partner firms in order to take a competitive position in market. There is also more sharing of resources and information, usually where the leading firm provides relevant information, funds, technology, equipment, and human resource and management skills to its dependent firms.

The disadvantage of this relationship is that the margin of the dependent firm is often squeezed by the leading firm. For instance many fruit and vegetable suppliers claim they operate under conditions where wholesalers or supermarket chains have more power than them. Some of the conditions which suppliers believed to be unfair are:

- There is no guarantee of price, or even of a fair price. It seems that wholesalers and retailers build partnerships in order to buy from suppliers as cheaply as possible.
- If the quality does not meet requirements, large companies reject the product or pay very low prices.
- Some large wholesalers provide soft loans and technical assistance to fruit and vegetable suppliers. However, if the production fails to achieve agreed targets (usually due to weather), the growers have to bear most of the loss.

### **Contractual relationships**

Contractual relationships between suppliers and customers mainly deal with suppliers giving customers permission or rights to sell their products. Such relationships are common in the case of high visibility branded food items because of many counterfeit products in the market. To protect their own

products, food processors typically give reputable distributors and retailers the right to sell their products at a fixed margin.

### **Conflicts facing suppliers and customers**

Given the immaturity of supply chain systems and the various types of relationships that coexist in chains, conflicts between suppliers and customers are unavoidable, and they have the potential to undermine the stability of distribution channels and the efficiency of business operations.

#### *Problems facing suppliers*

- Unreliable payments from customers. Unlike many developed countries, China lacks a well-established credit system and many suppliers in China experience either long delays or failure to pay from their customers. Many suppliers prefer to conduct small transactions to minimise the risk of large losses. Many international manufacturers marketing in China require Chinese distributors to order and pay before releasing their products;
- Cross region sales. Some regional representatives, instead of selling products within regions assigned by their suppliers, engage in cross region selling, causing market and price confusion and damaging the supplier's reputation;
- Lowering of prices. To obtain greater margins from suppliers, customers attempt to increase sales volume by dropping the price;
- Harsh conditions imposed by customers: Some large and powerful players in the distribution sector impose harsh conditions on suppliers;
- Squeezing margins: Customers always try to squeeze margins from suppliers rather than adding value;
- Customers shift suppliers often. Customers are very likely to swap suppliers for a cheaper price.

#### *Problems facing customers*

- Suppliers like to transfer risk to their customers. Some suppliers push their customers to accept their products in order to meet sales targets. Customers sometimes have to bear storage costs and the risk of products that are out of date;
- Suppliers leave customers: Customers can be abandoned by suppliers when suppliers change their marketing strategy;
- Suppliers provide no or inadequate support to customers;

These conflicts are not unique to China. According to channel management theory, under perfect market conditions in developed countries, channel members having independent proprietary rights in order to acquire economic benefits often end up in conflict with each other (Stern et al. 1996).

### **Considerations and issues for exporters**

Firms in Australia cannot control all the risks identified in this report. However some of the risk could be mitigated.

## **Reduce cold chain breaks**

Cold chain breaks are a major risk for firms exporting fresh, chilled or frozen food items to China. The main cause of breakdown is not the lack of cool chain storages or refrigerated transport tools. It is:

- lack of knowledge of product handling requirement;
- lack understanding of the consequence or the impact of cool chain broken down on the products; and
- lack coordination between firms.

Firms are usually un-willing to take responsibility to ensure that products will flow with the required temperature from producers to consumers due to the high level of uncertainty in the chain.

Australian firms need to build longtime relationships with not only the immediate customers, but also their customers' customers. This can help firms to create an environment in which a chain can be developed so that the knowledge of product handling can be passed down to the downstream of the chain. Australian firms need to consider whether their Chinese counterpart use reputable firms when sourcing third party logistic service.

In China most meat importers use their own cold chain system to ensure the safety of the products because even small mistakes in handling temperature-sensitive products could lead to serious consequences.

If the perishable goods have to be handled by a third-party logistics firm, smooth communication is essential and close monitoring or supervision should be in place. However, in the absence of a transparent monitoring and tracing system, it is difficult to effectively monitor the whole chain. In most cases, once the product is handed over to the next logistics firm, it is no longer traceable.

## **Reduce contamination**

A simple measure for Australia firms to reduce the potential contamination of their products in China is to work with Chinese firms who have China's food safety licenses. The following licenses are issued in China:

- Food Production Licence (食品生产许可证), for food producers;
- Food Distribution Licence (食品流通许可证), for food distributors;
- Food Catering Services Licence (餐饮服务许可证), for entities engaged in the food catering industry;
- Food Additives Production Licence (食品添加剂生产许可证), for entities engaging in the production of food additive

The second suggestion is to shorten the supply chain to reduce the risk of contamination. The third is to provide necessary training for Chinese

counterpart on how to handling products and the last is to work with firms in the chain to develop a monitory system.

### **Credit uncertainty**

Chinese currency can now be easily converted into any international currency. To reduce credit uncertainty, firms trading with Chinese firms should go to Chinese banks which have opened branches in Australian major Cities in recent year, asking for the letter of credit. The banks will act as a guarantor for payment.

### **Relationships**

Above all, the key for business success in China is relationships. All the risk and barriers described can be mitigated if an Australian firm has developed a strong relationship with its Chinese partner. Relationship development needs time. It is through communication, visitation and trial shipments of products that trusting relationship can be development gradually. It can take several attempts and a couple of years before confidence is developed in exporting food to China.

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