China’s retail food sector has matured rapidly, as consumers have increased their demand for convenience and quality in food products. A highly competitive food retail sector has emerged, featuring modern supermarket chains, wider choice in products, and branded items. The continuing evolution of China’s retail sector has important implications for how foreign and domestic food products reach the consumer. Producers—whether domestic or foreign—seeking to gain access to China’s consumers must navigate the country’s complex food distribution system.

From the 1950s through the 1970s, Chinese government entities procured, distributed, and sold nearly all agricultural commodities. In the early 1980s, there was little value-added in the country’s food system. Processed foods were limited, as most households prepared meals from rice, noodles, raw produce, and meat. Service and hygiene in food retail outlets were poor, and food distribution systems were inefficient.

Following the implementation of economic reforms in the late 1970s, food marketing was one of the first sectors in China to be privatized and directed by markets (table D-1). Producers were permitted to sell grain, produce, and meat to consumers in urban farmers’ markets. Small food stores, kiosks, and restaurants sprang up, and by the late 1980s, department stores were offering large food sections. Food processing output value in China reportedly grew at a 14-percent annual rate through the 1980s and 1990s (China Food and Agricultural Services). Away-from-home food spending was 15 percent of urban food expenditures in 2000, up from negligible amounts in the 1980s. Many different players entered the food retail sector, including small individual entrepreneurs, state-run companies and their privatized spinoffs, and prominent foreign-invested ventures.

New Formats Transform Food Retailing

China’s food retail sector was transformed dramatically during the 1990s by the rapid rise of supermarkets, including large domestic chains, such as Lianhua, Hualian, and Nong-gong-shang. Several foreign supermarket operators based in Japan, the Netherlands, and Hong Kong entered the China market, but most pulled out or reduced their presence as they found it difficult to compete with domestic firms. Margins in the fiercely competitive food retailing sector are very thin, and Chinese consumers are said to be highly price-sensitive. Numerous domestic competitors often received “soft” bank loans, reduced property rents, and the advantages of good personal relationships with distributors. At the same time, foreign entrants were at a disadvantage in coping with central, provincial, and municipal bureaucracies that sought to protect vested interests and support local retailers as a means of creating jobs for local workers. Independent domestic standalone supermarkets were also forced out of business or acquired by larger state-held chains.

More recently, supermarkets in China have been upstaged by foreign hypermarket retailers that offer low prices and an array of goods and services under one roof. These “hypermarkets” have extensive dry goods and frozen goods sections, fresh and frozen meat and seafood, prepared foods, and foodservice counters. They also include restaurants, fashion and sporting goods outlets, and other specialty shops. Many analysts predicted that hypermarkets would fail because Chinese consumers seldom shop for large quantities of goods and lack automobiles to carry home large purchases. However, hypermarkets won shoppers over by offering convenience, comfort, and low prices.

Hypermartket keep prices low through efficient supply chain management. The food distribution system used by supermarkets and other food retailers in China still has much inefficiency. Numerous layers of distributors exist between the manufacturer/importer and the

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1 The views expressed in this article are those of the author and do not necessarily reflect the views of Agriculture and Agri-food Canada.
retailer. Each layer receives a markup, relationships with the distributors are often as important as salesmanship, and most distribution is localized. Hypermarkets reduce distribution markups by purchasing goods directly from manufacturers and large distributors. Hypermarkets have also introduced modern store management and purchasing methods that are new to China. While most retail procurement in China tends to be localized, hypermarkets have sought to establish national distribution networks. Hypermarkets have also been able to keep prices low by supplementing their sales revenues with high listing, or slotting, fees paid by suppliers eager to place their products in these fashionable stores.

**Greater Efficiency in Food Distribution**

Hypermarkets have captured only a small share of the national market, primarily in wealthy coastal cities. The effect of hypermarkets on the China market, however, may be much wider, as domestic chains respond to the success of these stores. Just as the competitive threat of foreign supermarket chains in the 1990s led to improved customer service in domestic chain stores, the competition from hypermarkets may lead to even more choices for consumers in domestic stores and stimulate improvements in the efficiency and openness of the food distribution system. China’s major chains are increasing services offered to consumers, offering more fresh produce, and improving the efficiency of supply chain management to counter the success of the foreign hypermarkets. Domestic chains also have announced plans to expand into the hypermarket format.

The trend in China toward hypermarkets is paralleled by growth in smaller convenience food stores, which seem to complement hypermarkets. Convenience stores have captured the market for sales of small purchase items, such as drinks, packaged foods, snacks, and ready-to-eat foods. Foreign-invested chains popularized the format, but many convenience stores in China are now operated or franchised by well-known domestic chains. Similar to hypermarkets, convenience stores maintain their own warehouses and truck networks or tap into supermarket distribution networks of parent companies. Competitors of convenience stores—smaller local supermarkets, department stores, small foodstuff stores, “mom-and-pop” stores, and food kiosks—rely on less-efficient distribution systems.

**Deeper Penetration for Imports**

The development of the food retail sector may be an important factor in opening the China market to

### Table D-1—Description of retail food outlets in China

<table>
<thead>
<tr>
<th>Type of outlet</th>
<th>Typical product lines</th>
<th>Procurement methods</th>
<th>Operated by chains¹</th>
<th>Average outlets per city¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hypermarkets</td>
<td>Full line of fresh, frozen, and ready-to-eat foods, nonfood items, and services.</td>
<td>Establish direct links with manufacturers and importers.</td>
<td>90</td>
<td>90</td>
</tr>
<tr>
<td>Supermarkets</td>
<td>Full line of fresh and frozen foods, and nonfood items.</td>
<td>Work closely with local distributors.</td>
<td>75</td>
<td>1,200</td>
</tr>
<tr>
<td>Department stores</td>
<td>Packaged items and frozen foods. Usually one floor of a multistory retail space.</td>
<td>Use outdated purchasing systems.</td>
<td>50</td>
<td>40</td>
</tr>
<tr>
<td>Foodstuff stores</td>
<td>Packaged items.</td>
<td>Use informal, low-tech management and purchasing processes.</td>
<td>0</td>
<td>20</td>
</tr>
<tr>
<td>Convenience stores</td>
<td>Limited line of snacks, drinks and packaged items.</td>
<td>Tap into supermarket networks. Foreign-owned stores establish own distribution networks.</td>
<td>65</td>
<td>1,600</td>
</tr>
<tr>
<td>“Mom and pop” stores</td>
<td>Basic consumer products.</td>
<td>Buy from wholesale markets in small quantities.</td>
<td>0</td>
<td>30,000</td>
</tr>
<tr>
<td>Farmers’ markets</td>
<td>Fresh vegetables, fruit, meat, and seafood.</td>
<td>Buy from local farms.</td>
<td>0</td>
<td>50</td>
</tr>
</tbody>
</table>

¹ Estimated average for a major city, such as Beijing, Shanghai, or Guangzhou.

imports of food and agricultural products, especially high-value items. Imported items are not common in domestic supermarkets and are rare in smaller food retailers. These retail outlets tend to procure products locally due to China’s poor distribution system and a tendency for local governments to encourage local procurement to protect local producers or manufacturers. Imported items have a more substantial presence in hypermarkets, although even in these stores imports constitute no more than 5 percent of the stock. Nevertheless, the streamlining of distribution channels brought about by hypermarkets is likely to make it easier for imported food items to reach Chinese consumers. China’s World Trade Organization accession commitments are expected to make it easier to distribute imported goods within the country and may enable imports and foreign retailers, currently concentrated in a few large coastal cities, to penetrate smaller cities and interior provinces.

What We Need to Know

- Will efficient supply chain management practices be widely adopted by domestic retailers?
- Will a streamlined distribution system allow high-value imports to gain wider penetration of the China market?
- How will the evolution of food retailing affect the structure of food production and processing in China?
- What market penetration strategies will be successful as China’s retail and distribution systems mature and Chinese consumers become more sophisticated?

Effects on Producers

The maturing of the retail sector in China is also beginning to affect the way food is produced at the farm level. Foreign-invested retailers, processors, and chain restaurants have sourced most of their produce, meat, and other raw materials in China, but they have had difficulty obtaining reliable supplies of standardized quality products from China’s traditional system of small household farms geared toward producing food for home consumption. To keep pace with the demands of buyers, farms will have to adjust by specializing in a particular commodity, consolidating fragmented land holdings to achieve scale economies, and forging stronger links with processors and retailers. Closer relationships between firms at different stages of production and marketing are emerging as larger commercialized farm operations grow produce and animals under contract for processors, retailers, or exporters. This trend is likely to continue and may profoundly alter the way food is produced in China.

Further Reading
