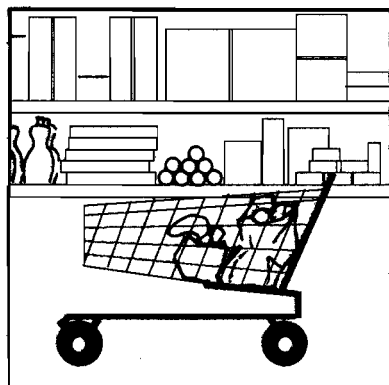
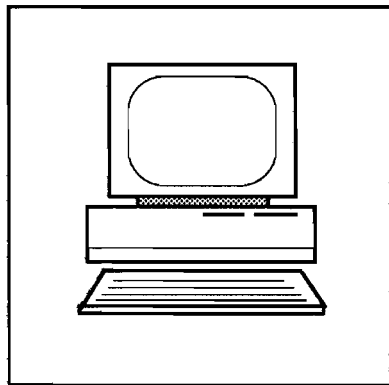
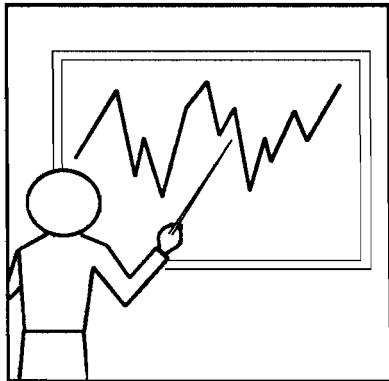


Cornell Food Industry Management Program



December 1996

E.B. 96-20

Supermarket Development in China

八百伴屬下以新加坡為基地的IMM國際批發中心有限公司 (IMM) 已簽署同意書成為Wal-Mart在亞洲六個國家之分銷商。Wal-Mart為美國最具規模及盈利的零售企業。IMM同運權。

WAL-MART進軍八百伴

像實的批發商銷售主要股東包括八百伴集團及新加坡IMM社長和田光正表示，以售價會比新加坡低百分之三十至歡迎情度已在首Ro 八百伴實，三貨櫃的部售。

和田光正表示，超過一億日元 (Wal-Mart貨品。會遠過日本的日財政年度的總銷約港幣九百四十)

▲快報 (

Yaohan supermarket set for opening

JAPANESE retail giant Yaohan will open its first joint-venture supermarket in China tomorrow, the first of 1,000 planned by chairman Kazuo Wada for the world's largest market.

"Our initial plan is to open five or six in Shanghai by the end of this year," said Zhou Erzong, head of the general manager's office at Shanghai Lian Nong Co, Yaohan's partner.



Gene A. German
Jane Wu
Ming Li Chai

Food Industry Management Program
Department of Agricultural, Resource, and Managerial Economics
College of Agriculture and Life Sciences
Cornell University, Ithaca, New York 14853

It is the Policy of Cornell University actively to support equality of educational and employment opportunity. No person shall be denied admission to any educational program or activity or be denied employment on the basis of any legally prohibited discrimination involving, but not limited to, such factors as race, color, creed, religion, national or ethnic origin, sex, age or handicap. The University is committed to the maintenance of affirmative action programs which will assure the continuation of such equality of opportunity.

Supermarket Development in China

Gene A. German
Jane Wu
Ming Li Chai

Cornell University
Food Industry Management Program

\$25 per copy
Copies may be purchased from:

Food Industry Management Program
113 Warren Hall
Cornell University
Ithaca, NY 14853-7801
Phone (607) 255-1622
Fax (607) 255-4776

Acknowledgments

The authors would like to express their appreciation to the Food Marketing Institute for providing a portion of the funding for this project. Also, our thanks to Vitasoy International for its financial support and to Winston Lo, President of Vitasoy, for his advice and insights regarding the China market.

We are grateful to Peter Weldon and Stephen Watt of the Survey Research Group of Hong Kong and China for their assistance in providing retail census data.

A special thanks to Mike Milligan, Tom Muccio, Stephen Goodroe and especially to Andy Jett, all of Procter and Gamble, for their assistance in providing special insights into the distribution system of the China market.

We would also like to express our appreciation to the many retail companies that provided information used in this report: Mr. Hiroaki Kawai, Yoohan International Holdings Ltd.; Mr. He Xiang Dong and George Lu of China Resources Supermarket Ltd.; Mr. Che Wan Cheng, Xiamen Yibai Department Store Co.; Mr. Liu Zhan Peng, Guangdong Foods Company; Mr. Zhao A. Long, Shanghai Lian Hua Supermarket Co.; Mr. Liang Dong, Xiamen Foreign Supply Corp.; and Mr. He Dechao, Foshan Xinghua Group.

We were also provided with special insights from a number of Chinese government officials which proved to be extremely helpful in developing a perspective on government regulations regarding the supermarket industry. We are grateful to the following government officials: Mr. Huang Hai, Ministry of Internal Trade, Beijing, Mr. Lee Shu Xiang, Shanghai City Government; Mr. Scott Reynolds, USDA Agricultural Trade Office, Beijing; and Mr. Wayne Molstad, USDA Agricultural Trade Office, Guangzhou.

Table of Contents

Introduction	1
Population	1
Historical Overview	1
Trends in the 90's.....	2
Economy	2
Growth and Development.....	2
Per-capita Income	3
Components of Expenditure	5
The New Wealthy and Purchasing Power	5
The New Economic Zones -- Windows to the Outside World	7
Special Economic Zones (SEZs)	7
Open Coastal Cities	7
Open Coastal Economic Areas	8
Pudong New Development Area	8
Free Trade Zones (FTZs)	9
Other Economic Zones	9
Supermarket Development in China.....	12
Supermarkets in China.....	12
Stages of Development	13
1981~1985: Introduction	13
1986~1990: Decline	14
1991~1992: Reintroduction	16
1993: Adjustment Stage	16
1994~1995: Growth Stage	17
Supermarket Development in Three Key Regions of China.....	17
Southern China--Guangzhou and Shenzhen.....	17
The Strong Influence from Hong Kong.....	17
Supermarket Development has been Strongly Influenced by Foreign Investment	17
Positioning Themselves as High Class Shopping Centers.....	18
Little Government Restrictions or Support	18
Strong Economy.....	18

Northern China--Beijing.....	18
Laissez-Faire	18
Many Well-Operated Local Supermarkets	18
Many Foreign Joint Venture Supermarkets.....	18
Middle China--Shanghai	19
Guidelines and Policies for Supporting Supermarket Development in Shanghai	19
Supporting Policies for Supermarket Development.....	20
National Government Incentives.....	21
The Introduction of Foreign Investment.....	22
A Summary of the Operational Performance of Supermarkets In China.....	23
Methodology	23
Supermarket Size	23
Number of Stock Keeping Units (SKUs).....	24
Supermarket Sales.....	24
Gross Margins	24
Expenses.....	24
Net Profit After Tax	25
Supermarket Operating Costs	25
Grocery Buying and Reordering	25
Capital Component	25
A Summary of Retail Census Analysis of Four Major Cities in China	25
Issues Facing Supermarket Development in China	26
Lack of Capital for Expansion.....	26
Hard to Find Store Locations.....	28
Poor Return on Investment	28
Lack of Management Know-How	28
Lack of Product Variety.....	28
Ineffective Buying Practices	29
Inefficient Distribution and Unreliable Delivery.....	29
Lack of Effective Inventory Management	29
Learning How to Manage a Market Driven Business.....	30
Shoplifting.....	30
Competition From Traditional Food Outlets.....	30
The Prospects and Recommendations for Future Supermarket Development ...	30
End Notes	33

List of Tables

Table 1:	National Income, Index of National Income and National Income Growth (1978-1993)	3
Table 2:	Annual Per-Capita Income of Rural and Urban Residents (1978-1993)	4
Table 3:	Total and Per Capita Saving Deposit Balances of Chinese Residents (1978-1993)	4
Table 4:	1993 Annual Per-Capita Living Expenditures of Urban and Rural Households (RMB)	5
Table 5:	Major Tax Incentives for Foreign Invested Enterprises in China's Economic Zones	10
Table 6:	Foreign Supermarket Firms in China	31

List of Figures

Figure 1:	GNP Trend 1978-1993	3
Figure 2:	GNP Growth in %	3
Figure 3:	Supermarket Status: Four Cities-1994	27
Figure 4:	Supermarket Status: Beijing-1994	27
Figure 5:	Supermarket Status: Shenzhen-1994	27
Figure 6:	Supermarket Status: Shanghai-1994	27
Figure 7:	Supermarket Status: Guangzhou-1994	27

Introduction

China's 1.2 billion population is an enormous attraction to many retailers and manufacturers of consumer products that have begun to vie for this huge potential market. Not only does the number of consumers continue to grow, but China's economy has experienced an impressive growth since its reform in 1978. China's GNP grew 10 percent or more during the early 1990's. This figure is especially impressive when compared with the rest of the world which was facing an economic downward trend. Also, per-capita income rose at an average rate of 10.8 percent since 1990. Chinese consumers can now afford a better quality of life with an increase in consumption of both necessary and luxury products. However, the old system of centrally controlled distribution and retailing can no longer cope with the increasing consumption rates under the new market economy. This increasing demand has provided the proper environment as well as strong incentives for developing new supermarkets as part of China's retail industry. Since the late 80's and early 90's, in order to stay competitive locally as well as globally, many Western and Asian retailers have actively explored opportunities in China hoping to capture as much market share as possible in this attractive and dynamic market.

China has been undergoing many transitions including its economic system, social structure, consumption habits, etc. It is this dynamic nature of China that makes national growth rates or income numbers insufficient in understanding the retail market as a whole. Therefore, this paper will attempt to provide the reader with an understanding of the issues regarding China's population, economic growth and development, purchasing power, development of the new wealthy, and new economic zones as a background for retail development. Next, the paper will address:

- an overview of the economy
- what defines a supermarket in China
- the stages of development in the supermarket industry
- development in three key regions of China
- government involvement
- summary of operational performance from store surveys
- issues facing supermarket development in China
- analysis of data on four major cities from retail census

Finally, the paper will provide concluding remarks on the prospects and recommendations for future supermarket development in China.

Population

Historical Overview

Population has not always been an issue of concern in China. When the People's Republic of China was formed in 1949, its population was 541.67 million people. China experienced two peaks in population growth during the periods of 1950-1957 and 1962-1971. These two population surges could be a result of a series of macroeconomic

policies after the establishment of the PRC government and lack of proper government guidance during the cultural revolution. By 1969, China had a population of 806.71 million people. Since the 1970's, the central government began to realize the negative impact that the enormous population imposed on the economic growth of the country, and a series of birth control and planned parenthood policies were implemented. Since then, the birth rate declined until it hit its lowest point in 1984. However, the babies born during the second population peak reached child bearing age around 1986 and, once again, the nation was faced with another population crisis. This remnant effect will likely last until late 1990's.

Trends in the 90's

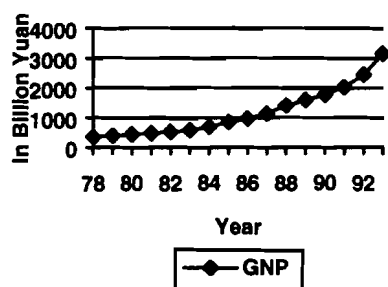
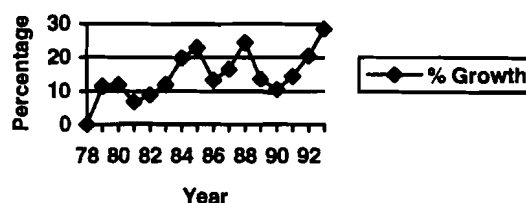
Rigorous enforcement of the one-child policy for over a decade has to affect population patterns. According to the 1994 Statistical Yearbook of China, the population was slightly greater than 1.18 billion in 1993, or about one-fifth of the world's population. About 28 percent of the population dwelt in urban areas and 72 percent in rural areas. China's population was 1.192 billion in 1994. Since 1990, the population has maintained a steady annual growth rate of about 1.1 percent, which is equal to about two-thirds of the entire population of Australia. According to the US Bureau of the Census, the projected Chinese population could reach 1.26 billion by the year 2000.

In 1994, China's largest population segment was between the ages of 20 and 29 and was born during the second population peak between 1962-1971. This large number of shoppers has sizable consumer clout. They are young and eager to make the transition to consumption habits that will create a demand-driven retail market. This mass of young consumers, especially the urban dwellers, form a great market for services that retailers can provide. On the other hand, as China's population is aging rapidly and as social and family supports have given way, the economic conditions of the elderly group have worsened. Rapid inflation is eroding fixed pensions and health care established under the old communist system. In 1994, 6 percent of the population was over age 65.

Economy

Growth and Development

Growth in China's economy has been very impressive following the country's economic reforms which have been occurring since 1978. During each of these past 17 years, the gross national product (GNP) has exceeded 4 percent. During about half of those years the GNP exceeded 10 percent. By 1993, China's GNP was more than ten times the size of its GNP in 1978 (Figure 1). However, this tremendous growth in the economy took place during the reform period when corrective measures created a series of boom-bust cycles. From Figure 2, we observed that 1981, 1986, and 1990 are at the low points of the cycle due to corrective measures established to cool down an overheated economy. Even with the continuing fluctuation of the growth rate, it appears China could achieve an average annual GNP of about 8-10 percent for the remainder of the century.

Figure 1 GNP Trend 1978-1993**Figure 2 GNP Growth in %**

China's economy is difficult to compare to international measures such as US dollars. Using the official exchange rate, China's per capita GDP increased from US\$259 in 1981 to US\$370 in 1990 which is hardly consistent with an average annual per capita growth rate of over 8 percent experienced in the 1980's in terms of yuan. The official exchange rate may be misleading due to the significant depreciation of the Chinese yuan over the past 15 years and also due to the difficulty in determining the prices of goods and services in non-tradable sectors.

Per-Capita Income

National income in China has grown from 301 billion (unit of Chinese currency (RMB) in 1978 to 2,488 billion RMB in 1993 (see Table 1). Based on comparable prices of consumer goods, national income has increased by 377 percent in 15 years and the annual growth rate averaged 10.8 percent since 1990. In 1992 and 1993, income grew by more than 15 percent compared with the previous year (see Table 1).

Table 1
National Income, Index of National Income and National Income Growth
(1978-1993)

Year	National Income (1 billion RMB)	Index of National Income* (1978=100)	Annual National Income Growth** (%)
1978	301.0	100.0	12.3
1980	368.8	113.9	6.4
1985	702.0	183.2	13.5
1990	1,438.4	263.7	5.1
1991	1,655.7	284.0	7.7
1992	2,022.3	327.7	15.4
1993	2,488.2	377.2	15.1

Source: Statistical Yearbook of China 1994

*based on comparable prices

**compared with the previous year

The income level of both urban and rural Chinese residents has increased, although actual income levels of rural Chinese are still far below those in urban areas. Per-capita income of rural residents increased from 134 RMB in 1978 to 922 RMB in 1993 which, when deducting the inflation factor, resulted in an actual annual increase of 5.9 percent and an overall increase of 338.6 percent over the 15 years. Per-capita income of urban residents increased from 316 RMB in 1978 to 2,337 RMB in 1993, which was an overall increase of 251.6 percent and an annual increase of 6.3 percent when the price factor is deducted (see Table 2).

Table 2
Annual Per-Capita Income of Rural and Urban Residents
(1978-1993)

Year	Income of Rural Residents		Income of Urban Residents	
	Net Annual Income	Index	Net Annual Income	Index
1978	133.6	100.0	316.0	100.0
1980	191.3	138.1	439.0	127.0
1985	397.6	261.2	685.3	161.6
1990	686.3	300.7	1,387.3	197.8
1992	784.0	328.1	1,826.1	228.3
1993	921.6	338.6	2,336.5	251.6

Source: Statistical Yearbook of China 1994

Greater income has not only boosted the purchasing power of the Chinese people, but also increased of their savings (see Table 3). The balance of saving deposits of rural and urban residents has risen from 21.06 billion RMB in 1978 to over 1,520 billion RMB in 1993, while the average per-capita saving deposit balance has also increased from about 22 RMB in 1978 to 1,283 RMB in 1993 (see Table 3).

Table 3
Total and Per-Capita Saving Deposit Balances of Chinese Residents
(1978-1993)

Year	Savings Deposit Balance of Rural and Urban Residents (1 billion RMB)	Average Per-capita Saving Deposit Balance (1 RMB)
1978	21.06	21.88
1980	39.95	40.47
1985	162.26	153.29
1990	703.42	615.24
1992	1,154.54	985.35
1993	1,520.35	1,282.81

Source: Statistical Yearbook of China 1994

Components of Expenditure

More than 70 percent of an average Chinese citizen's household expenditures in both urban and rural areas was spent on food, clothing and general merchandise (see Table 4). Spending on food accounted for more than half of the annual household expenditures and was far larger than spending for other goods. Many staple foods as well as housing expenditures are subsidized by the government. Health care is also subsidized by the government. Expenditures for medical care average only 3 percent per Chinese household. Chinese citizen's spending on education and recreation is the third largest category of expenditures. In 1993, 7.6 percent of the average rural household's total consumption went for education and recreation, compared with 9.2 percent for the average urban household. The ordinary Chinese family does not commonly own an automobile or telephone, and since public transportation is very inexpensive, only 3 percent of the average Chinese household's total living expenses in 1993 were spent on transportation and communications (see Table 4).

Table 4
1993 Annual Per-Capita Living Expenditures of Urban and Rural Households
(RMB)

Living Expenditures	Per-Capita Rural Household		Per-Capita Urban Household	
	Value	%	Value	%
Food	446.83	58.0	1,058.20	50.1
Clothing	55.33	7.2	300.61	14.2
General Merchandise	44.67	5.8	184.96	8.8
Residence	106.79	13.9	140.01	6.6
Health care	27.17	3.5	56.89	2.7
Education and Recreation	58.38	7.6	194.01	9.2
Transportation and Communication	17.41	2.3	80.63	3.8
Others	13.07	1.7	95.50	4.5

Source: Statistical Yearbook of China 1994

The New Wealthy and Purchasing Power

Is per capita income a realistic guide when examining China's potential consumer market? According to the Statistical Yearbook of China, annual per capita income of urban Chinese households in 1993 was \$453US, and rural households was \$161.7US. Field Force Integrated Marketing Solution Group, a Taiwan based marketing consulting firm, conducted the *Consumer Behavior Research in Mainland China 1994* in Beijing, Shanghai, and Guangzhou. According to this research, in 1993, per-capita income of Beijing residents was \$840US, income of Shanghai residents was \$1052US, and income of Guangzhou residents was \$1,431US (7). These figures were about twice the official figures in these three cities. A recent study by the International Monetary Fund reported Chinese per-capita income at about \$2,000US in terms of purchasing parity (2). This

figure took price level into consideration and illustrated that about \$2,000US value of merchandise can be purchased in China with about \$500US of per-capita income. A recent report by management consultants, McKinsey and Company suggests that consumer spending for luxury items is triggered at the per capita annual GNP threshold of \$1000US. According to the Statistical Yearbook, China has five cities that exceed this threshold -- Shenzhen, Guangzhou, Shanghai, Beijing, and Tianjin. The Hong Kong Trade Council estimates that 16 cities will be among this elite by the year 2000.

In the course of gathering data for this paper, it was learned that the Chinese government imposes a limit on workers' wage level, and if workers are paid above this set limit, employers will be taxed or fined. To avoid these taxes, workers are often compensated with consumer products rather than with higher wages. According to a supermarket retailer in Shenzhen, it is a common practice among employers in China to purchase daily necessities in bulk several times a year and distribute them to workers as a form of a 'bonus'. For example, some of the more widely accepted bonuses are the 'summer cooling fee' and 'winter warming fee' etc. It is evident that reported incomes do not reflect actual purchasing power as bonuses in the form of food products drive down the cost of living for the average Chinese citizen, and much income goes unreported.

The number of well-off Chinese is growing in spite of the low income reported per capita. Not surprisingly, most of them reside in the Special Economic Zones and in the coastal cities. This group of new wealthy consumers have a comparatively high level of disposable income and thereby has substantial purchasing power. This class of new wealthy can be categorized as follows:

1. Entrepreneurs of private business. Since the economic reform, there has been a growing trend in establishing private business among able individuals. This trend has been especially evident in the Special Economic Zones (see next section) and in the coastal cities. These entrepreneurs generally have substantial wealth.
2. Managerial personnel of foreign business. These local Chinese managers are very well paid for their ability to establish foreign businesses in the local market. However, wages are still low compared to, for example, the managerial wages in Hong Kong.
3. Personnel serving in a special trade. Interviews with taxi drivers in China indicated that a substantial portion of the money they receive is never reported as income, since they are paid in cash and receipts are not required. Also, sales representatives and buyers have sizable incomes from commissions on sales or remittance from suppliers in addition to the salary that in most cases goes unreported.
4. Leaders of profitable government-owned organizations. Profitable operations provide ample 'public accounts' for various expenses enjoyed by leaders and workers of that organization.

5. Opportunists. These are clever individuals who take advantage of China's economic system in transition using their well established 'guan xi' or human resource relations.

This group of well-off Chinese has abundant income and possesses the purchasing power which has the greatest impact on the retail industry. They will be leaders in the development of Chinese consumer trends. Since time is becoming more valuable, they tend to shop mostly during weekends or holidays. Also, they demand better quality products and the clean, pleasant shopping environment that the supermarket provides.

The New Economic Zones -- Windows to the Outside World

Many economic zones with different incentive conditions were established in China soon after its sweeping economic reform in 1978. These economic zones serve as a mechanism for opening China's market to the outside world and as an example for guiding the economic development of the entire country. The objective of these economic zones is to allow market forces to work by helping increase the productivity and efficiency of the economy within the socialist market economy framework. These new economic zones include: Special Economic Zones (SEZs), Open Coastal Cities, Economic and Technological Development Zone (ETDZs), Open Coastal Economic Areas, Pudong New Development Area, Free Trade Zones (FTZs), and other areas.

Special Economic Zones (SEZs)

In 1980, the four cities in southern China that became the SEZs were Shenzhen, Shantou, and Zhuhai in Guangdong Province, and Xiamen in Fujian province. The Hainan Island was elevated to provincial status and designated the fifth SEZ in 1988. The SEZs were given unprecedented special privileges, as compared to the inland cities, including preferential tax policies for foreign joint ventures and have considerable leeway to approve foreign investment projects at the local level (see Table 5). The SEZs have been established to:

1. attract foreign investment in all sectors of the economy including retail industry,
2. keep in pace with the trends and activities in the international markets
3. expand export trade, and
4. facilitate participation in the international business and technological cooperation.

The SEZs are the obvious cities of entry for many foreign retailers such as Yaohan, Welcome, Park-N-Shop and Wal-Mart.

Open Coastal Cities

In 1984, fourteen Open Coastal Cities were established. They consisted of Beihai, Dalian, Fuzhou, Guangzhou, Lianyungang, Nantong, Ningbo, Qingdao, Qinghuangdao, Shanghai, Tianjin, Wenzhou, Yantai, and Zhanjiang. These cities were granted greater

autonomy to approve contracts and offer special incentives, such as capped land use fees, tax exemptions, and tax holidays (Table 5). The scope of the permitted operations in the Open Coastal Cities is very similar to that of the SEZs. Each city was allowed to establish an Economic and Technological Development Zone (ETDZ) to offer further tax reductions and holidays outside the city core (Table 5). Since 1992, many major foreign retailers including Yaohan, Park-N-Shop, Carrefour, Makro, and others have set up joint venture operations in Guangzhou and Shanghai.

Open Coastal Economic Areas

In 1985, China decided to further expand the open coastal areas extending the entire section of the country into an open coastal belt. These areas consisted of Pearl River delta and the area surrounding Guangzhou; the Yangtze River delta around Shanghai area including Suzhou, Wuxi, and Changzhou in Jiangsu Province, Jiaxing and Huzhou in Zhejiang Province; and the Southern Fujian-Min River delta including Xiamen, Quanzhou, and Zhangzhou in Fujian Province. In 1988, the Shandong and Liaoning peninsulas were added extending the Open Coastal Economic Area to more than 260 cities and counties in China. These areas offer similar incentives to that of the Open Coastal cities (Table 5). These areas are designed to integrate the high-growing export oriented production industries of the coastal cities with raw material and component productions in the interior cities. Obviously, the rapid economic development in these Open Coastal Economic Areas will provide favorable conditions for developing retail industries in these areas.

Pudong New Development Area

In 1990, Pudong New Development Area was established to attract foreign investments with less stringent regulations and more economic incentives. The 350 sq. km zone is located on the eastern bank of the Huangpu River, facing Shanghai on the other side of the Huangpu River. It is the government's intention that Pudong will serve as a leader in promoting economic activities for cities further up the Yangtze River and hasten the pace of reform in the Yangtze Delta region. Also, Pudong is vital in turning Shanghai into an international economic, financial and trade center. Pudong receives many similar economic incentives as the SEZs (Table 5). However, the government has extended special preferential policies to the Pudong New Development Area which are not enjoyed by the SEZs. For example, foreign companies can set up financial institutions, department stores, supermarkets, and other tertiary enterprises in Pudong without involving a local partner. Pudong itself is subdivided into four zones namely Lujiazi Financial and Trade Zone, Jinqiao Export Processing Zone, Waigaoqiao Free Trade Zone, and the Zhangjiang High-Tech Park. Over 4000 industrial sites are currently under construction in Pudong.

Free Trade Zones (FTZs)

As of June 1994, thirteen Free Trade Zones have been established and they are Dalian, Futian, Fuzhou, Guangzhou, Haikou, Ningbo, Qingdao, Shantou, Shantoujiao, Tianjin, Xiamen, Waigaoqiao, and Zhangjiagang. The FTZs are small special district with closed access facilities allowing duty and tax free import and processing of goods for export. FTZs also allow foreign trading, banking, and insurance companies to set up operations in their boundaries. Foreign investors in FTZs are eligible for many similar benefits available to SEZs or ETDZs (Table 5).

Other Economic Zones

Since 1992, the government has established many more special economic zones including 52 high-tech industrial development zones, 18 open provincial or regional capital cities, 11 State tourism and holiday zones, 13 open border towns. These zones are authorized to extend preferential policies on par with the open coastal cities (Table 5).

Table 5
Major Tax Incentives for Foreign Invested Enterprises in China's Economic Zones

	Nationwide	SEZs	ETDZs	Pudong New Development Area
Mfg. Income Tax Rates	30%	15%	15%	15%
Non-mfg. Service Industry Tax Rates	30%	15%	15%	15%
Service industry investing over \$5 million with terms of at least 10 years	No nationwide exemptions	Tax exempt for the first profit making year, followed by a 50% reduction for the next 2 years (7.5% tax rate)	Same as SEZs	Same as SEZs
Foreign Joint Venture Banks or Branches (investing at least \$10 million for at least 10 years)	30%	15%, but tax exemption for the first profit making year, followed by 50% reduction for the next 2 years	30% for bank's representative offices; 15% for bank's branches approved by the State Council	15%
Income Tax Rates for Enterprises Certified as Export Oriented or Technologically Advanced	15% in any year, if they export more than 70% of their output	10% upon the expiry of income tax exemption for an export oriented enterprise; technologically advanced FIEs qualify for 50% reduction for 3 years after expiry of exemption (7.5% rate)	Same as ETDZs	Same as ETDZs
Income Tax Refund for FIEs with Reinvested Profits	40% tax refund paid on profits reinvested or used to establish other enterprises for the last 5 years	Same as nationwide	Same as nationwide	Same as nationwide
Local Income Tax Rates	Generally 3% (10% of national tax rate), but often waived by the locality	0%, however subject to locality	Same as SEZs	Same as SEZs
Dividends, Interest, and other Non-earned Income	10% for US companies	10%	Same as SEZs	Same as SEZs
Repatriation of profits	10%	Exempt	Same as SEZs	Same as SEZs

Table 5 continued

	Open Coastal Cities (14 cities)	High-Tech Zones (52 areas)	Free Trade Zones (13 FTZs)	Open Coastal Economic Areas (260 cities & counties)
Mfg. Income Tax Rates	24%, but 15% if FIE is technologically advanced, investing at least \$30 million, or investing in transportation or harbor industries	15%, but must be approved as high- tech enterprises	15%, but rates are subjected to locality	24%, but 15% if FIE is technologically intensive, investing at least \$30 million, or investing in energy, transportation, or harbor industries
Non-mfg. Service Industry Tax Rates	24%	30%	15%, but rates subject to locality	24%
Service industry investing over \$5 million with terms of at least 10 years	Same as ETDZs	Same as ETDZs	Same as ETDZs	Same as ETDZs
Foreign Joint Venture Banks or Branches (investing at least \$10 million for at least 10 years)	15%, but rates are subject to approval by State Tax Administration	Same as Open Coastal Cities	Same as Open Coastal Cities	Same as Open Coastal Cities
Income Tax Rates for Enterprises Certified as Export Oriented or Technologically Advanced	12% in any year if FIE exports more than 70% of their output; technologically advanced FIEs qualify for 50% reduction for 3 years after the expiry of exemption (12% rate)	Same as ETDZs	Same as ETDZs	Same as Open Coastal Cities
Income Tax Refund for FIEs with Reinvested Profits	Same as nationwide	Same as nationwide	Same as nationwide	Same as nationwide
Local Income Tax Rates	Same as SEZs	Same as SEZs	Same as SEZs	Same as SEZs
Dividends, Interest, and other Non-earned Income	Same as SEZs	NA	NA	NA
Repatriation of profits	Same as SEZs	NA	NA	NA

Source: Compiled by Piper Lounsbury from US-China Business Council Files

Supermarket Development in China

Supermarkets in China

In China, where the concept of the supermarket is still emerging, there is no clear definition of what type of retail store constitutes a supermarket. The concept is still so new to consumers as well as to retailers and suppliers that many sizes and types of stores now fall under the umbrella of this definition. Most of the stores classified as supermarkets are small by comparison to industry standards in other countries. It is quite common to define a self-service store of 100 square meters as a supermarket. In most other Asian countries as well as the United States, convenience stores are typically larger than 100 square meters and supermarkets are usually 1,000 square meters or larger.

The fact that stores as small as 100 square meters are included in the definition of supermarkets in China may be due to the urban nature of their development as well as to the fact that many new "supermarkets" are simply conversions of old stores that previously offered only clerk service. By introducing self-service shelving, these stores are arbitrarily proclaimed to be supermarkets.

For consumer goods to effectively reach the market, there must be an adequate distribution system as well as appropriate retail stores. China's distribution system is undergoing enormous change, and its retail stores are still in the very early stages of development. The self service supermarket is truly a new concept to the Chinese consumer.

How is the supermarket perceived by the average Chinese shopper? It is a store with a wide selection of foreign packaged food products. It is a clean store that features self-service shopping. And it is still somewhat of a novelty where consumers shop infrequently or on special occasions. It may be easier to describe the supermarket by explaining what, to Chinese consumers, it is not. It is not the place consumers go to buy their basic food needs - such as rice, grains, cooking oil, or fresh fruits and vegetables. These products are purchased at the wet market or from small neighborhood shops. The supermarket is not the lowest priced food store for consumers. Bargains are to be found in the wet markets and neighborhood stores which often have lower prices due to very low overhead.

Low income consumers would probably never shop in a supermarket because the products would be considered luxury items, or at least somewhat "specialty products". Since nearly all rural consumers fall into the low income category, only urban consumers would frequent the supermarket and then only for special occasions.

Will the supermarket become a more common shopping experience for the average consumer in China? The answer is yes.

Stages of Development

Supermarket development in China has proceeded in a very different manner than in other countries of the world. History has reported that the first supermarket of record was opened in the United States in 1929 in response to the severe economic downturn known as the Great Depression. The strategy of this first United State supermarket was to offer consumers food at lower prices in a large self-service environment.

After World War II, the supermarket experienced its greatest growth in the United States and its self-service store concept has been widely accepted by other developed and developing countries.

In China, supermarkets are known as self-service stores, and they emerged in the early 1980s when the government introduced its first efforts to liberalize the market and vitalize the economy. Self-service stores first appeared in China in major cities like Shanghai, Guangzhou and Beijing. These stores, however, did not attempt to attract consumers with low prices, like the early supermarkets in the United States, but focused on a marketing strategy based on offering consumers a wide variety of products and clean, neat stores. Therefore, consumers are lured to supermarkets in China not because of any promise of "savings" but because the supermarket offers a wider choice of products in a pleasant shopping environment.

Supermarket development in China from 1981 through 1995 can be divided into five major stages: introduction, decline, reintroduction, adjustment and steady growth. (4) (8).

1981~1985: Introduction

The Guangzhou Friendship Store marked the introduction of the supermarket in China. This store, which was opened in 1981 was patterned after typical western supermarkets and also reflected the influence of nearby Hong Kong retailers. The store was considered a novelty, and there were very few other supermarkets opened during the early 1980's. This slow pace of growth in the number of supermarkets lasted for about four years until 1985, when a number of retailers began testing self-service stores in China. By the end of 1985, there were about 155 self-service stores throughout China. Beijing had 51 self-service stores, about one third of China's total, and there were about 20 self-service stores in Shanghai.

Self-service stores during this period can be classified into three types in terms of capital sources, products, and customers (8):

1. The first type was the supermarket that was solely funded by Hong Kong investors or a supermarket in which Hong Kong investors formed a joint venture partnership with Chinese local enterprises. These supermarkets were primarily located in cities such as Shenzhen that were near the border of Hong Kong. The major customers were foreign travelers from Hong Kong or other countries as well as Chinese who returned from living abroad or who

possessed foreign exchange certificates. The products found in these supermarkets were imported from Hong Kong and consisted primarily of food although the stores also sold some general merchandise. In some cases supermarkets even had a clothing section. An example of this type of store was the Park-N-Shop Supermarket which opened in Sherquo, Shenzhen.

2. The second type of supermarket was owned and operated by local enterprises. Their major customers were also foreigners and Chinese who were returning from living abroad. Some stores served local Chinese residents as well. Most of the products they carried were packaged foods, and some, but not all of them, were imported. The Guangzhou Friendship Store, Foreign Trade Center Supermarket, and Shipping Foreign Supply Supermarket were examples of this type of supermarket.
3. The third type was the self-service supermarket that was also owned and operated by local firms. They were located in major cities but in contrast to the other types of supermarkets which catered to foreigners, these stores served the ordinary Chinese customers. It has been estimated that 90 percent of these stores sold only food. Most of the products were locally made although some stores also sold a few imported products.

The stores in Beijing are good examples of the development of self-service stores in China during this introductory period. The first self-service store appeared in Beijing in 1982. By the end of 1983, the number of self-service stores had reached 20. In 1984, another 21 self-service stores opened to bring the total number to 41. By the end of 1985, there were 51 self-service stores in total. During this introductory period, the most rapid growth of self-service stores occurred between 1984 and the first two quarters of 1985.

The majority of these self-service stores (6) sold only food and vegetables. The stores had refrigerated equipment to keep the foods fresh. Seven of these self-service stores were department stores which sold only general merchandise. Six of them sold only grains and oils. Most of these self-service stores were small with less than 500 square meters of total store space. The smallest ones were only about 100 square meters in size (4).

1986~1990: Decline

Between 1986 and 1990, there were several unfavorable factors in the market environment that caused the number of supermarkets to decline and by the end of 1989, many supermarkets that had been opened during the introductory period had been closed or returned to clerk-service stores. For instance, in Shanghai, the number of supermarkets shrank from 20 in 1986 to only one in 1989. This decline, according to Mr. Lee, Shou-Shiang of the Office of Finance and Trade of Shanghai city government, was attributable to the following reasons:

1. Lack of product variety: Local suppliers could not meet the needs of supermarkets in terms of product quantity, quality, and most importantly,

variety. For many supermarkets, the lack of sources of supply was a big problem.

2. Shopping habits of Chinese consumers: Because the supermarket was still very new to the ordinary Chinese consumer they were not yet comfortable shopping in these stores. Their purchasing habits did not include many of the products found in supermarkets. Consumers needed more education regarding the advantages of shopping in supermarkets to accept this new idea.
3. Lack of professional management skill: Most managers had experience in operating traditional clerk-service stores, and when they began to manage supermarkets, they found themselves lacking in experience and knowledge.
4. Inappropriate positioning strategy: Many supermarkets positioned themselves as high class shopping centers and targeted high income customers; this strategy limited the development of the supermarket because of the limited number of consumers in this target group.
5. The old structure of the economy was an obstacle: Conflicts between the central government and local governments and among regions and professions in the old economic structure hindered the expansion of supermarkets. In China's original structure of the so called stripe-and-lump economy each of the different professions, or product categories such as sugar, tobacco, grain and oil had its single source of supply and a direct hierarchical relationship called a strip. This meant that the product was distributed straight down from the central organization at the top to the local retail shop at the bottom.

Since supply in China's communist economy has never been sufficient, conflicts occurred among regions (called lumps) when they all needed supply from one single source. The supermarket compounded this problem because it is a business that requires various categories of products. This means that when a supermarket opens a store in one region, supplies for other regions must be diverted to the region where the new supermarket opened. Also, every profession had its own retail outlets that did business directly with the local consumers and the profit was submitted back to the central government. When supermarkets entered the market, they took a great deal of sales away from these specialty stores. All of these conflicts between the central government and local governments and among regions and professions have curtailed supermarkets from opening more stores and bringing in products from other parts of the country. The result was that supermarkets either could not get approval for opening new stores or could not obtain enough sources of supply.

1991~1992: Reintroduction

The economy of a society has to be developed to the point where consumers have sufficient disposable income to support the supermarket industry. Of all the reasons mentioned for the decline of the supermarket industry in the 1980s, the major contributor was the weak economic situation in China. The economic situation as measured by disposable consumer income was not favorable for the survival of the supermarket during the 1980's.

In the early 1990's, China's economy experienced rapid growth. In 1991, GNP grew at the rate of 8.2 percent, double the growth rate of 4.1 percent in 1990. In 1992, GNP established a new growth record of 13.4 percent compared with the previous year (5). Income level increased more than three times compared to the level ten years ago and consumer spending increased at the same rate, providing a favorable climate for supermarket development that was lacking during the 1980's.

Another measure of economic growth that had a positive influence on supermarket development was the fact that more than 95 percent of all households in Shanghai now have a refrigerator (1). Many double income families have developed a need for a convenient, time saving, one-stop shopping retail outlet that fits into their new contemporary life style.

In addition, improvements in manufacturing technology and communication have provided a suitable environment for the development of the supermarket. There is a greater variety of products available in the market and more products are packed into package sizes that are appropriate for supermarkets

In May, 1990, China joined the International Association of Bar Code Systems. The Shanghai city government also founded the Bar Code Center which required products sold in supermarkets to have bar codes on packages in order to allow for scanning in supermarkets. Although it may take some time to implement this requirement, both foreign and domestic producers began to comply. Computers were also introduced into many supermarkets to improve efficiency and to take advantage of the scanning opportunity that bar coding provided (8).

Under these favorable conditions, the supermarket industry experienced its second introduction between 1991 and 1992. New stores mushroomed throughout China in major and secondary cities. In Shanghai, for example, the rate of growth in the number of new supermarket openings was about one store every two to three days. By the end of 1992, there were about 200 self-service supermarkets in operation in Shanghai (8).

1993: Adjustment Stage

In 1993, a small number of supermarkets withdrew from the market due to unsuccessful positioning strategy or bad location. These stores either went out of business, moved or merged with other supermarkets. During this period of time, the pace

of new store openings slowed as many existing supermarkets were adjusting their operation to better fit the business environment and better serve their customers (8).

1994~1995: Growth Stage

By 1994, Chinese customers were becoming familiar with foreign products as well as Chinese packaged foods. They also had become more familiar with the supermarket concept. By 1994, many Chinese consumers had become experienced supermarket shoppers and even developed a one-stop shopping habit. Supermarket executives were learning from experience what operational strategies and tactics were most effective in their stores. Social and economic situations had developed to support the supermarket industry. Within this positive environment the development of the supermarket industry in China entered its steady growth phase in 1994. In Shanghai, according to Mr. Lee, Shou-Shiang of the Office of Finance and Trade of the Shanghai city government, 133 more new supermarkets were opened during 1994, which increased the total number of supermarkets in Shanghai to more than 450.

Supermarket Development in Three Key Regions of China

The supermarket industry has developed very differently in various regions of China due to different circumstances and local government policies. Between 1990 and 1994 there appears to be three distinct influences affecting supermarket development in three separate regions of the country.

Southern China -- Guangzhou and Shenzhen

The Strong Influence From Hong Kong

Consumer preference of citizens living in southern China has been strongly influenced by the geographic proximity of Hong Kong. People living in Shenzhen and Guangzhou are aware of many foreign products and brands due to the mass media coverage from Hong Kong and will inquire at stores to find out if they carry them. When these products find their way into the markets in southern China the prices of these products are also affected by the pricing strategy applied in Hong Kong.

Supermarket Development has been Strongly Influenced by Foreign Investment

The supermarket industry is becoming increasingly competitive in Southern China. Many Chinese retailers are eager to form joint venture relationships with foreign retailers in order to obtain capital and introduce management and operational expertise into their stores. A number of Hong Kong-funded supermarket chains have established a retailing presence in southern China. For instance, the Hua-Ren Supermarket Company, with 40 percent ownership from Hong Kong China Resources Purchasing Company Ltd. (CRC), had 21 stores in Shenzhen by the end of 1994. Also, Park-N-Shop, a Hong Kong supermarket firm, operated 22 stores in Shenzhen in 1994. In Guangzhou, Wellcome Supermarket from Hong Kong was negotiating a joint venture partnership in 1994 with a major supermarket company in Guangzhou.

Positioning Themselves as High Class Shopping Centers

Most of the supermarkets in southern China position themselves as up-scale stores that offer quality products, better services and nice shopping environments. Therefore they do not compete in price and charge more than other nearby small grocery stores.

Little Government Restrictions or Support

In principle, local governments throughout southern China encourage the development of supermarkets. However, in practice, there is little support from the government in terms of incentives and supportive policies. On the other hand, there are few restrictions to limit supermarket growth.

Strong Economy

Southern China had strong economic growth in the early 1990's. Guangdong province had the highest total value of retail sales (139.970 billion RMB), as well as the highest number (44,705) of registered foreign enterprises of any province in China by the end of 1993 (5).

Northern China -- Beijing

Laissez-Faire

Although located in the capital city, supermarkets in Beijing do not have many restrictions from the government. Although the government has taken a positive attitude in support of supermarket development, it has offered little financial support.

Many Well-Operated Local Supermarkets

People living in northern China are relatively conservative and they have always had fewer opportunities and less desire to purchase foreign products than people living in the south. This is reflected in the operations of the average locally-run supermarkets. In Beijing, the capital city, many well operated local supermarkets still maintain the style and merchandising approach of traditional Chinese food stores. The majority of their products are locally procured, including fresh meat, sea food, and unique products from different regions of the province.

Many Foreign Joint Venture Supermarkets

Many foreign enterprises have entered the modern retail market in Beijing. For example, Parkson from Malaysia, Jusco from Japan, and Wellcome from Hong Kong had opened supermarkets in Beijing in 1994 and provided a wide variety of food products for local residents.

Middle China -- Shanghai

Guidelines and Policies for Supporting Supermarket Development in Shanghai

The Shanghai city government has exercised a very strong influence on the development of its local supermarket industry. Several guidelines have been set forth by the city government in an attempt to establish supermarkets that meet global standards. In 1991, in order to set an example, the Office of Finance and Trade of the Shanghai city government helped to establish the Lianhua Supermarket Company. In 1994, after a number of supermarkets went out of business due to unsuccessful positioning strategies and poor decisions regarding store location, the Office of Finance and Trade (OFC) founded the Self-service Stores Association and took several actions to encourage the development of the supermarket (8). For instance, the OFC advertised extensively to both the business community as well as to ordinary consumers in an attempt to promote the concept of supermarket shopping. They invited academic experts and top management personnel to speak to the retailers about new developments in the supermarket industry. Also, they sent managers to other countries to study and to emulate overseas supermarket operations. In addition, the OFC organized meetings for supermarket executives to exchange experiences and develop strategies to improve their operations. Furthermore, they conducted a broad survey of the current supermarket situation for the purpose of discovering reasons why supermarkets succeed or fail. Based on the findings, the OFC established guidelines for the future development of supermarkets. Mr. Lee, Shou-Shiang of the Office of Finance and Trade of the Shanghai city government, described a number of major guidelines that had been established to encourage supermarket development. These included:

1. Ordinary people are the targeted customers of supermarkets. Supermarkets are given the mission from the Shanghai city government to upgrade the average consumers' standard of living. This is reflected in the supermarket's low price approach and in the city government's requirement that supermarkets locate in the suburbs where people live.
2. A supermarket should be located at the rural-urban fringe, in new residential areas or highly populated areas.
3. New stores should be at least 500 square meters in size. In 1994, the average size of the 133 new stores that opened in Shanghai was 700 square meters (data obtained from the survey).
4. New stores are required to have at least 2,500 different products or stock keeping units (SKUs).
5. New stores must carry fresh produce. (Most supermarkets in China in 1994 did not.)

6. New stores are required to have refrigerators for perishable items and freezers for frozen products. The amount of the equipment to be determined by the size of the store.
7. Computerized systems and chain-like management development were encouraged. In order to survive under rigid restrictions as well as take advantage of the incentive policies of the city government, many companies are establishing chain store management and computerized operating systems to realize the economy of scale to control operating costs.

In addition, the city government has other general guidelines for store hours and services, such as selling newspaper and stamps, collecting utility charges, installing public phones and micro wave ovens to better serve customers.

Supporting Policies for Supermarket Development

The city government also realized that the development of the supermarket truly depends on the cooperation and coordination with other industries and professions. According to Mr. Lee, Shou-Shiang, the OFC has attempted to coordinate related sectors and establish supporting policies:

1. In order to support supermarkets with capital for expansion, the city government allocated 100 million RMB to appointed financial institutions as a supermarket development fund which would be loaned to supermarket enterprises at a very low interest rate. State-owned supermarket companies are provided 2 million RMB, one million from the city government interest free (and as some have suggested, perhaps repayment free, due to the ambiguity of company ownership) and the other one million from the fund through bank loans. The city government, along with the district government, has pledged to support half of the interest on the one million RMB loan.
2. In helping supermarket expansion, the city government provides rent control by putting a ceiling on rent increases. However, if a new store makes a profit within the first three years, the real estate department of the city government can double the original rent. This is the lowest rate of increase in the rent regulation. Normally, rent can be raised up to nine times the original rent if the company is making a profit.
3. Sales tax on grains, oils, and fresh produce will be reimbursed to all supermarkets.
4. Joint ventures enjoy all the same benefits as outlined above for state-owned supermarket companies. The Shanghai city government is taking a positive attitude to encourage foreign enterprises to invest in one of three ways: (1) joint venture, (2) joint management and (3) cooperation in the entire food marketing channel including food manufacturing, processing and wholesaling. So far, only joint ventures have been widely used. The other two forms will need more time and negotiation. Foreign retailers from many countries have established outlets in

Shanghai. Japanese enterprises of Yaohan and Daiei have formed joint venture relationships with different Chinese retailers and planned to have stores in operation in 1995. Ito-yokoto invited Chinese supermarket managers to visit their stores in Japan and plans to open stores in Shanghai. Park-N-Shop from Hong Kong is also expanding its outlets from Shenzhen to Shanghai. Carrefour, a French-based hypermarket retailer, has formed a joint venture with the Lianhua supermarket Company to develop hypermarkets in Shanghai. In general, the city government prefers that the Chinese partner have the majority of the ownership, however, negotiation is possible.

Given these incentives and supporting policies, the supermarket industry in Shanghai developed steadily in 1993 and 1994. In 1994, 133 new supermarkets opened in Shanghai, 33 percent more than planned. These new stores were much larger than supermarkets built in the early 1990's and averaged more than 700 square meters in size. Product variety has increased and averaged over 3,000 SKUs in 1995. In addition, these new supermarkets offer more services than ever before. As a whole, supermarket outlets are located more evenly across the city with 90 percent of the stores now located in suburban residential areas. The chain store format has been further developed. For example, by the end of 1994, Hualian supermarket company had 25 stores, Lianhua was operating 24 stores and Triangle had more than 10 stores. Due to the operation of multiple stores, economies of scale have been improved. For instance, in 1994, Hualian reached a break even point in its operation after one and a half years of losing money. The total sales of their 25 stores had reached 200 million RMB (data obtained from the survey).

Although the Shanghai city government is the most supportive government in supermarket development, it also places the greatest regulations on supermarket operations. In other cities, the local government support is not as strong as in Shanghai, and there are fewer incentives from other local governments to foster the newly developed industry.

As of 1994, the supermarket industry in Shanghai was developed more extensively than other cities in China. However, when the supporting policies are no longer applicable, supermarket companies in Shanghai will have to develop their own strategies to survive in the highly competitive market.

National Government Incentives

In addition to the regulations set forth by the Shanghai City Government, there are a number of special National Government Initiatives that have been important in shaping the development of supermarkets in China. Although some of these have been modified (and continue to be adjusted) as retail development continues throughout China these initiatives have provided the basis for the direction of supermarket growth from its infancy. The following is a list of some of the more important National Government Initiatives:

1. Formalize national development plans for the supermarket industry in China and encourage local governments to provide special support (as in the case of Shanghai).
2. Permit each of the 14 special economic zones and 6 open cities to establish two joint-venture retailing firms with foreign supermarket companies. (Note: this initial plan has been modified in some areas).
3. Allocate financial credit for developing supermarket chain store organizations. The purpose of this initiative was to encourage Chinese supermarket companies to develop chain store organizations in order to benefit from the economies of scale that larger organizations afford.
4. Encourage the training of supermarket managers and employees at home and abroad. The Government encourages joint venture partners from other countries to provide special training outside of China. The Government feels that Chinese managers need to see other supermarket operations and “benchmark” against foreign supermarkets. Therefore, foreign study trips and other types of training abroad are encouraged.
5. Strengthen communication and information exchanges about supermarket development throughout China. A national supermarket organization was recommended as a means of sharing information between managers. In addition, the Government has recommended newsletters as well as national and regional conferences relating to supermarket activity.

The National Government Initiatives have provided the framework for development of supermarket organizations in China. Certainly local governments will follow the lead of the Shanghai City Government in developing additional guidelines for supermarket growth. Should foreign supermarket companies become more dominant it is likely that various government agencies will place restrictions on their growth and development in order to allow local Chinese firms to establish themselves in the market.

The Introduction of Foreign Investment

Since 1992, the municipalities of Beijing, Shanghai, Tianjing, Guanzhou, Dalian, Qingdao, and each of the five Special Economic Zones (SEZs) which include Shenzhen, Xiamen, Shantou, Zhuhai, and Hainan have been allowed to introduce, with the State Council's approval, two large foreign-funded retail businesses, although these locally-approved foreign ventures lack direct import power and must import products through their Chinese partners or trading companies (3).

During the early 1990's, Hong Kong and Japanese companies have been the first foreign entrants in China's newly opened supermarket sector. Some European and American companies have also started to establish outlets in major cities in China. In Shanghai, Yaohan International, a Japanese retailer, opened a large department store-supermarket complex and has announced plans to have 40 conventional supermarkets by

the year 2000. Park-N-Shop from Hong Kong had 22 stores in Shenzhen by the end of 1994 and had started to expand their chain stores in Shanghai. Also in Shenzhen, The China Resources Group of Hong Kong had 21 supermarkets and announced plans to open another 6 stores in 1995. The Wellcome Supermarket Company from Hong Kong was attempting to form a joint venture with a supermarket company in Guangzhou. Walmart, the giant discount retailer from the United States, opened its first 2 stores in Shenzhen in 1995 and also plans to expand into other cities in China. Carrefour, a French hypermarket retailer, has signed a contract with Lianhua Supermarket Company of Shanghai and has opened two hypermarkets of 4,000 to 5,000 square meters in 1996 (information obtained from interviews).

A Summary of the Operational Performance of Supermarkets in China

Methodology

In order to better understand supermarket operations in China, as well as to collect specific store operations data, a field study trip was organized. The study trip took place in December 1994 and involved visits to nine Chinese supermarket companies in Shenzhen, Guangzhou, Foshan, Shanghai, Beijing and Xiamen. The general managers had all agreed in advance to share store operating data and to discuss major issues facing the supermarket industry in China.

During each visit the food marketing search team from Cornell interviewed General Managers from leading Chinese supermarket companies and asked them to complete an extensive survey dealing with the operation of their companies. The survey and interviews focused on the issues the companies faced as well as operational characteristics of each firm. The following is a summary of these findings:

Supermarket Size

There are quite a few small self-service stores in each city. The size of these small self-service stores was about 100 square meters. Stores which are classified as supermarkets are larger than these small self-service stores, however, even the larger supermarkets tend to be much smaller than supermarkets in the United States. The average size of these new self-service supermarkets in China was below 300 square meters. Those supermarkets opened in 1993 and 1994 have an average size of 300 to 500 square meters, with some stores as large as 1000 square meters. In 1995, the more typical size of a supermarket in China was between 300 and 700 square meters. A self-service store of this size was considered to fall within the limits of an acceptable definition of a supermarket by the general managers of the Chinese supermarket companies interviewed for this survey.

Number of Stock Keeping Units (SKUs)

The total numbers of SKUs varies quite dramatically between different stores and different areas in China. The number of SKUs range from 500 to 7,000. Typical supermarkets in China carried between 2,500 and 4,500 items. These products were primarily packaged goods, and except for supermarkets in Shanghai and an occasional supermarket in Beijing, most supermarkets did not carry fresh fruits and vegetables or fresh meat items. Due to the short supply of grocery products, (consumer packaged goods) the variety of products Chinese supermarkets carry is not as extensive as in US supermarkets.

Supermarket Sales

In the United States a self-service food store is defined as a supermarket if it generates two million dollars or more in sales per year. Sales per store is a critical measure in classifying the store as a supermarket. In China where the supermarket is such a new concept, store sales is not used as a criteria for classification of store types. Because store size varies widely and because the supermarket is not widely utilized by Chinese consumers, there is a huge variation in the average store sales reported by supermarket companies responding to this survey. The typical weekly sales range of supermarkets operated by companies responding to this survey was 70,000 RMB to 300,000 RMB, with some firms reporting sales higher then this and some lower. Sales vary considerably depending on the location and size of the store. Large stores in highly commercialized areas report weekly sales of 500 RMB (or higher) per square meter. However, in smaller stores in suburban residential areas, weekly sales can be lower than 50 RMB per square meter. However, sales growth is very promising for supermarket chains due to new store development and consumer acceptance.

Gross Margins

The average gross margin for Chinese supermarkets is about 20 percent. In the early 1990's, many stores had margins over 20 percent, however, by 1994, supermarket companies in general have seen their margins drop to less than 20 percent. For many supermarkets, goods are priced according to fixed gross margins.

Expenses

The major operating expense for the supermarket companies included in this survey was rent, which ranged from a low of 2.8 percent of store sales, to a high of 6 percent. Most of the respondents to this survey (general managers of supermarket companies) indicated that the rent expense for their company would increase over the next few years, making it an even more important factor in the overall expenses of the store. Labor, which is typically the largest of all expenses for supermarket companies in the United States, ranged from 2 percent of total store sales to 3.8 percent.

Net Profit After Tax

Supermarket firms responding to this survey reported net profits after a 15 percent tax rate as high as 4 percent of total sales and as low as a loss of more than 1 percent with a typical profit of about 3 percent of total sales. Several general managers indicated that it was very difficult to operate a business on a profitable basis, especially in their new stores. Some of the companies have been in business for several years and were just beginning to show a profit.

Supermarket Operating Costs

Labor cost averaged about 2.5 percent of total sales, much lower than that of supermarkets in developed countries. Rental cost was on average 5 percent of total store sales. Utilities cost less than 2 percent of total store sales for most supermarkets. The cost of shrinkage was less than 0.6 percent of total sales. Among all the causes of shrinkage, shoplifting was reported as the most serious problem, and some managers felt that it could account for half of the shrinkage loss.

Grocery Buying and Reordering

Headquarters buyers have the major control over buying decisions. Some chains allow 20 percent of the buying decisions to be made by the store manager. The average reordering cycle varies from 20 to more than 50 days, depending on the company's inventory strategies and the storage space in its warehouses.

Capital Component

Most supermarket chains are solely government owned. However, some Chinese supermarket companies are able to obtain a small amount of capital from foreign investors. This is expected to change as more large foreign retail companies begin to enter the China market and invest more heavily in joint venture opportunities.

A Summary of Retail Census Analysis of Four Major Cities in China

In 1994, a census was taken of various types of retail stores in a number of major cities throughout China by the Survey Research Group (now part of A.C. Nielsen) of Hong Kong. In this census retail supermarkets were placed in four categories: (1) large western supermarkets (101-499m²), (2) large Chinese supermarkets (101-499m²), (3) traditional supermarkets (100 m²), and (4) super grocery supermarkets (500m²). To be classified as a supermarket the stores had to carry primarily food and grocery products and be self-service. The large Chinese and the large Western supermarkets were classified as such due to the type of products they carried. These stores appeared only in large urban cities which may have contributed to their small size -- given the difficulty in securing retail space in Chinese cities. Also, the stores may have been small in this early stage of development because of the fact that they were converted from retail space that

had previously been used for traditional service grocery stores. The traditional service grocery store was a prime target for supermarket development because of its good locations, and customers were in the habit of buying food and grocery products from that location.

In this study, four large Chinese cities were analyzed in terms of the development of supermarkets. The cities were: Shenzhen and Guangzhou in the south, Beijing in the north and Shanghai on the coast.

In 1994, the Survey Research Group (SRG) census of China indicated that there were 1,002 supermarkets in these four cities (see Figure 3). Large Western supermarkets accounted for the largest number of stores with 664 and traditional supermarkets were second with 194. There were 86 large Chinese supermarkets and 58 super grocery stores, 500m² or larger in size.

Beijing had the most supermarkets of the four cities with 418 and Shanghai was second with 408 (see Figures 4 and 5). In both of these cities the most dominate type of supermarket was the large Western. Shanghai had more super grocery stores with 31.

In both Shenzhen and Guangzhou the traditional supermarket was the most common (a store about 100m²) with the large Western supermarket second in total numbers (see Figures 6 and 7).

Issues Facing Supermarket Development in China

Lack of Capital for Expansion

Due to the lack of capital, Chinese supermarket companies have problems in expanding their outlets to achieve economies of scale. In Shanghai, for example, there are a number of small food stores as well as grain and oil stores that would provide excellent locations for the establishment of supermarkets. Since many of these stores have been losing money for a number of years, they would be eager to join with supermarket firms to improve their sales and profits. Supermarkets that take over these stores and sign a contract of joint management are required to pay rent and compensation for the use of the stores, and they also have to employ the workers from the original stores. Short term contracts of less than 10 years are usually allowed, however, once the contract is expired, there is no guarantee that it will be renewed.

Supermarkets established in the form of joint management need capital of at least 3 million RMB for big stores and 1.5 million RMB for small stores not including the additional 300 thousand to 1.5 million RMB for decoration, shelving and equipment. Many supermarkets have experienced problems in expanding their business because of the lack of capital. For example, Shanghai Lianhua Supermarket Company needed to invest 5 million RMB in a store of 500 square meters. In 1994, they had a debt of about 20 million RMB and were paying interest of about 2 million every year (8). Lianhua has established a joint venture with Carrefour, a French retail company, which will provide needed capital for growth and expansion.

Figure 3

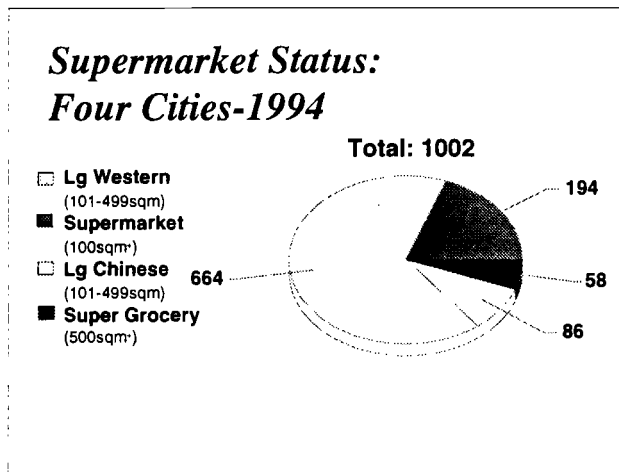


Figure 4

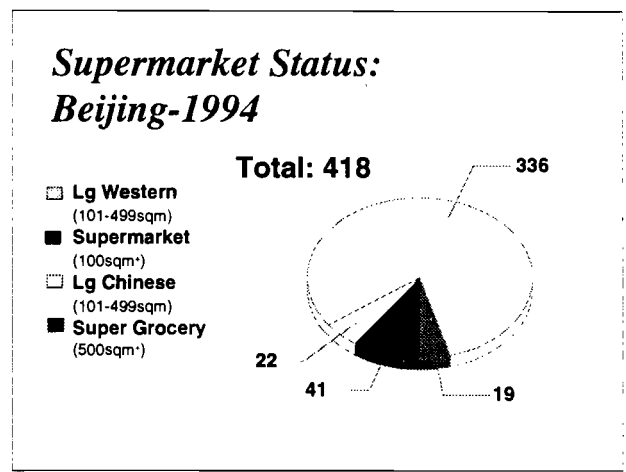


Figure 5

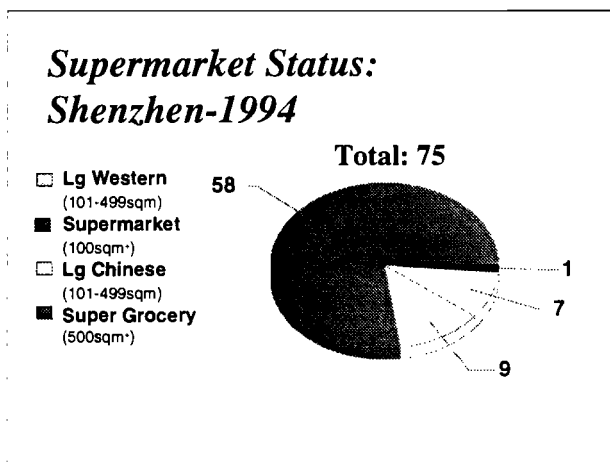


Figure 6

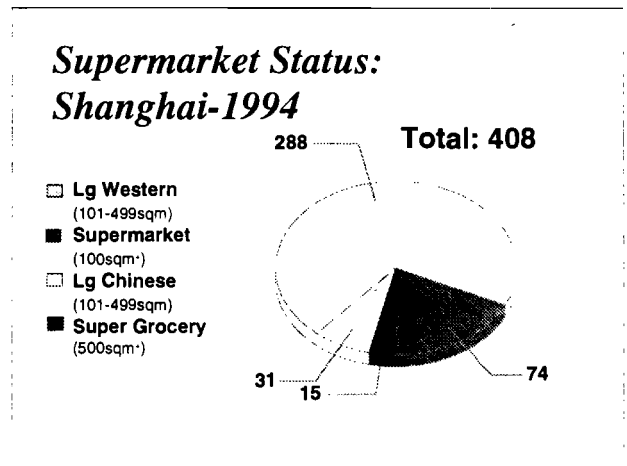
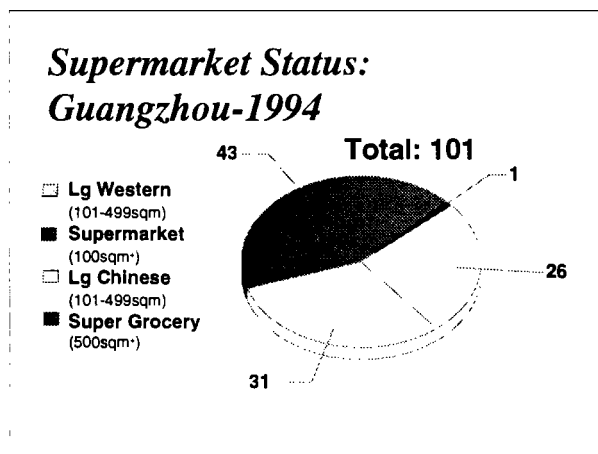


Figure 7



Hard to Find Store Locations

Rent in urban and suburban areas of China increased during the early 1990's because many new businesses were springing up. Supermarkets found it very difficult to compete with businesses such as banks and real estate companies in seeking new store locations due to the supermarket's low profit structure. Many other enterprises can afford to pay higher rent than supermarkets.

Poor Return on Investment

Most Chinese supermarkets report that it will take 3 to 5 years for a supermarket to become profitable. Most supermarkets in China are still in their very early phase of operation. In Shanghai, very few supermarkets were making a profit in 1994. One supermarket general manager estimated that a chain must have 14 stores of 300 to 500 square meters to break even and at least 16 stores to achieve the economies of scale in order to become profitable. Since very few chains have this number of stores it is difficult for the supermarket industry in Shanghai to operate at a profitable level, at least in the short run (8).

Lack of Management Know-How

Since the supermarket is relatively new to Chinese retailers, many supermarket executives are not willing to adopt new ideas in the to operation of their stores, and the old system and structure is not suited to a market driven economy. For instance, before supermarkets became chain organizations, store's purchasing personnel took the full responsibility for buying. Their job was considered a lucrative position because they often received payment from manufacturers under the table. As the store transformed to a member of a supermarket chain, it also had to adopt the supermarket's chain buying system in which buying decisions were no longer made by store personnel but by the purchasing committee at the chain headquarters. The store employees that previously did the buying now view the central buying group as encroaching on their duties.

On the other hand, headquarters executives are not well informed in modern chain operations. They do not have experience in buying a wide variety of products and managing more than one store. They also have difficulties recruiting people who have experience and knowledge in supermarket operations. Senior managers from the old system are often very reluctant to accept new ideas. Without new ideas and merchandising methods, training managers and employees find it difficult to be effective (4) (8).

Lack of Product Variety

In many supermarkets in China, shelf space is not fully utilized. Supermarkets are eager to obtain a wider variety of products. However, local manufacturing technology of packaged foods and products has not caught up with the demand.

Ineffective Buying Practices

Buyers of food and grocery products lack information in finding product sources and often procure products indirectly from middlemen at less competitive prices. Also, a common problem facing new supermarket companies is that buyers frequently accept under the table payments from suppliers who are seeking special arrangements, such as a favorable display location. (information obtained from the interview with Mr. Liou, President of Guangdong Foods).

Inefficient Distribution and Unreliable Delivery

Many supermarket chains do not have distribution centers. A great deal of inefficiency may occur in delivery. China's inferior transportation system is also a serious problem leading to shipping delays and unpredictable lead time. Because of traffic jams and poor refrigeration facilities, many perishable products such as frozen foods are either out of stock or they deteriorate in quality on route to the store.

Lack of Effective Inventory Management

Traditionally, grocery store managers used their experience to manage inventory. When their stores transformed to supermarkets, they lacked experience in handling a large number of products. Some supermarkets have introduced computer systems to assist with inventory control, yet their computer software is either out of date or seldom utilized (information obtained from the interview with Mr. Liou, President of Guangdong Foods). Because of poor inventory control, many products are left on display past their expiration date, resulting in poor quality products being sold to customers.

However, one of the most serious problems is irregular group purchasing by state-owned enterprises. State enterprises are supposed to follow the regulations in giving cash bonuses to their employees by paying a tax on the bonus to the central government. In order to avoid paying this tax, many state enterprises substitute food products for cash bonuses. They buy large amounts of food products from a supermarket as a substitute for an employee bonus or to subsidize their regular salary. This kind of transaction often happens on special holidays and creates an out of stock situation for the supermarket. Since this activity is designed to avoid paying taxes, it is prohibited. Supermarkets can not have contract agreements with these enterprises in order to plan ahead for these purchases. Because this kind of buying usually involves personal contacts, supermarkets that have special relationships with the buying personnel in state-owned enterprises often have a greater chance to obtain this business. However, because this kind of business is purely built upon personal relationships, the sale will not be guaranteed once the person who is in charge of purchasing leaves the job. Supermarkets usually don't have any way to acquire and secure this type of transaction, nevertheless, according to Mr. Loo, General Manager of Hua-Ren Supermarket Company, his supermarket chain has begun to send greeting cards to frequent purchasing personnel in state-owned enterprises to remind them to come back again.

Learning How to Manage a Market Driven Business

Not having been exposed to a market economy, retailers in China need to learn how to employ marketing strategies in response to consumer needs and also to provide friendly customer services.

Shoplifting

Shoplifting is a problem for many self-service stores, especially the stores located in big cities where transient populations come from all over the country to look for jobs. Many of these people are very poor and often hungry and have never been exposed to a retail store where they can truly touch and handle food products. However, according to the Mr. Liou, General Manager of Guangdong Foods Company, employee theft is another major cause of products loss in their supermarkets.

Competition From Traditional Food Outlets

Chinese people have been shopping for fresh meats and produce at wet markets and dry foods and daily necessities at neighborhood grocery stores for hundreds of years. They do not believe that the vegetables and fruit in supermarkets are as fresh as in traditional wet markets, and they do not think supermarket personnel can be as friendly as the small store owners they have known for years. Perhaps most importantly, they can not bargain for lower prices at the supermarkets. This deprives them of one of the pleasures of shopping. Traditional shops also have lower prices than supermarkets. These family-run stores have much lower overhead and fewer facilities. In addition, they sometimes carry smuggled foreign products that have avoided high tariffs and therefore can be sold at very low prices.

The Prospects and Recommendations for Future Supermarket Development

The management of most Chinese supermarket companies appear to be cautiously optimistic about the future of the supermarket in China. One general manager when asked how he would grow and develop his supermarket company in the future replied that when undertaking a new venture such as the supermarket he would be guided by the old Chinese proverb and "cross the river by feeling the stones at the bottom of the river." In other words, he would move his company ahead very carefully -- one step -- or one store at a time.

For Chinese supermarket companies to be successful they need management know-how -- an understanding of how to meet customer needs and how to manage a customer oriented work force. Secondly, they need supermarket operational know-how. Since the concept is new in China there are very few managers trained in self-service, large store, supermarket operations. They need to learn merchandising strategies and gain knowledge in day to day supermarket operations (ie, labor scheduling, inventory control, space management, buying, pricing, etc.)

And finally Chinese supermarket companies will need additional financing if they are to grow and be competitive in the market place. One primary source of this financing is expected to be from joint ventures with foreign supermarket companies. Local Chinese firms can be attractive partners for a foreign supermarket company since they can provide important store locations for growth and expansion as well as knowledge of the local market.

In addition, the Chinese companies know the local government officials that will have to approve new store locations, issue permits and provide approval for many of the activities of the business.

In 1995, there were over 100 foreign joint venture supermarkets open or planned for 1996. Most of the foreign supermarket companies were from Asia, although there were also several from Europe (see Table 6).

Table 6
Foreign Supermarket Firms in China

Company Name	Country of Origin	Cities in China	Number of Stores
Carrefour	France	Shanghai	1, 5 planned
China Resource Group	Hong Kong	Shenzhen Guangzhou	21
Daiei	Japan	Tianjin	1
Jusco	Japan	Shanghai Qingdao	1 (1996) 1 (1996)
Makro	Holland	Guangzhou	1 (1996)
Metro	Germany	Shanghai	1 planned
NTUC Fair Price	Singapore	Beijing	Planned
Park-N-Shop	Hong Kong	Shenzhen Guangzhou Shanghai	21 1 3
Parksons	Malaysia	Beijing	1
7-Eleven	Hong Kong	Shenzhen	22
Watson's	Hong Kong	Beijing Shanghai Guangzhou	3 2 1
Wellcome (Dairy Farm)	Hong Kong	Shenzhen Beijing	5 1
Yaohan	Japan Hong Kong	Beijing	10 planned

In 1995, supermarket development in China was in its early introductory stage. Many retailers had tried and failed -- many had found ways to be successful. Chinese consumers were still learning about supermarkets, but most had never shopped in one. Those that had shopped in supermarkets did not do so on a regular basis -- but only for

special occasions. The exception was the “new wealthy” consumer with a higher level of disposable income than the average urban consumer. But the growing success of supermarkets and the increasing consumer demand for more and better products has set the stage for widespread supermarket growth in the major urban centers of China. Shanghai appears to be the early focal point of development as indicated by the large number of foreign supermarket companies that have targeted that city for new stores. In addition, the Shanghai City Government has taken a pro-active stance to encourage supermarket growth. There will certainly be a great deal of new store growth over the next ten years. However, caution may well be the by-word as firms carefully “cross the river, by feeling the stones at the bottom of the river.”

End Notes

- 1 “Amazing Growth in China’s Consumer Market,” China Business and Investment Monthly Report (Vol. 33, November 1994), p. 202, Taiwan, ROC.
- 2 Dravo, Ed, “Beware of the Chinese Bubble,” FW (September 13, 1994), p.70.
- 3 Ho, David and Leigh, Nancy, “A Retail Revolution,” The China Business Review (January-February, 1994), pp. 22-27.
- 4 Liang, Xine-Chen, The Research Report on Self-Service Stores, Beijing, PRC, Beijing Graduate School of Business and Mechanical Engineering, March, 1987.
- 5 Statistical Yearbook of China 1994, Beijing, PRC, China Statistical Publishing House, 1994.
- 6 “Ten Illusions in Managing the Chinese Market,” Business Week (December, 1993), pp. 35-37, Taiwan, ROC.
- 7 Wang, Wen-Jing, “Money Flood--Purchasing Power in Beijing, Shanghai, and the Pearl River Delta,” Business Week (December 1993), pp. 65-66, Taiwan, ROC.
- 8 Yu, Shu-Hua and Lee, Chuei-Fang, The Development of Supermarket Industry in Shanghai--The Current Issues and Recommendations, Shanghai, PRC, Department of the Supermarket, Shanghai City Government, September 1994.

Food Industry Management Program

Available Publications

The following publications are available at \$25 each. Discounts are available on multiple copies of any individual report. Direct orders to: Cornell University, 113 Warren Hall, Ithaca, NY 14853-7801, or phone 607/255-1622 or fax 607/255-4776. Foreign orders should be payable in U.S. funds and drawn on a U.S. bank.

Dairy Department Procurement Dynamics, The Role of the Supermarket Buyer, Edward W. McLaughlin and Debra J. Perosio, R.B. 96-06, May 1996.

What's In Store for Home Shopping? Kristen Park, Debra Perosio, Gene A. German and Edward W. McLaughlin, E.B. 96-05, April 1996.

Supermarket Bakery Consumers, Attitudes, Preferences, Behaviors, Edward W. McLaughlin, Gerard Hawkes, Kristen Park and Debra Perosio, R.B. 95-01, February 1995.

Category Management, Current Status and Future Outlook, Edward W. McLaughlin and Gerard F. Hawkes, E.B. 94-28, December 1994.

Fresh Fruit and Vegetable Procurement Dynamics: The Role of the Supermarket Buyer, Edward W. McLaughlin and Debra J. Perosio, R.B. 94-1, February 1994.

Supercenters: The Emerging Force in Food Retailing, Gene A. German, Gerard F. Hawkes and Debra J. Perosio, A.E. Ext. 93-15, October 1993.

The Changing Role of the Korean Food Store in New York City, Edward W. McLaughlin and David M. Russo, A.E. Res. 92-07, September 1992.

Where to Find Information on the Food Industry: A Researcher's Guide, Edward W. McLaughlin and Sandy Freiberg, A.E. Ext. 92-19, August 1992.