



MONTHLY REPORT

TRADE SERVICING

– WUSATA

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Market: China & HK Submitted by: China/HK In-market Representative Month & Year: April 2024

Executive Summary

The food industry in China is constantly in flux, with new players emerging and disappearing on a weekly basis. For example, when discount stores selling near sell-by date snacks became a craze in early 2024, many stores of same business models popped up around smaller Chinese cities before the majority of them quickly went out of business. Meanwhile, flavor-of-the-month products are also the same, businesses are rushing to produce the latest hit products as cash grabs, and often times these products are not properly regulated and managed, with low-quality or even ingredients involved in the end often causing safety scandals which dragged along players who are doing it the right way. Recent examples include prepared meals and starch sausage, which eventually saw enough bad apples getting into the business that the names themselves are now associated with negative perception from consumers.

On the other hand, imports from countries such as the U.S. have largely maintained their reputations in China, with consumers still mostly believing there is greater transparency, safety standards and control, and pride from overseas manufacturers when producing the products. This is especially evident for manufacturers from North America, Europe, Australia and New Zealand. Interests for U.S. products from Chinese traders are rekindling, and while China's economy is still somewhat stagnant, exporters should look at the e-commerce channel which has continued to grow, in particular cross-border e-commerce, which allows overseas exporters to bypass some of the bureaucratic challenges that are present for the regular import channel.

Market Intelligence Update

China's Pet Food Industry is Full of Malpractice

China's love for pets has ushered in a thriving economy, where furry friends are no longer just animals but cherished members of the family. However, a dark shadow looms over the industry – the alarming revelations of substandard pet food products.

In recent years, China's pet food market has experienced exponential growth, paralleling the increasing number of households welcoming pets into their lives. Unfortunately, with this rapid expansion, concerns about product quality have emerged, painting a concerning picture for pet parents.

A series of investigative reports have exposed distressing practices within the

industry. Some pet food manufacturers, driven by profit margins, have resorted to using inferior ingredients and misleading labeling tactics. The recent scandal involving “toxic dog food” originating from Xingtai, a major pet food production hub in Hebei Province, sent shockwaves across the country.

Reports revealed shocking details of manufacturers incorporating low-quality materials into their products, including stone and feather meal, while falsifying nutritional content to deceive consumers. Such deceptive practices not only compromise the health and well-being of pets but also erode the trust between consumers and the pet food industry.

Furthermore, excessive use of additives like montmorillonite, intended to mask the risks of inferior ingredients, poses long-term health hazards to pets, exacerbating the already precarious situation. Pet parents find themselves navigating a maze of uncertainty, grappling with the daunting task of ensuring the dietary safety of their beloved companions.

Numerous pet parents have taken to social media to share harrowing experiences of pets falling ill or even succumbing to death after consuming substandard pet food products. Even reputable brands have not been immune to the specter of tainted products, further amplifying concerns among consumers. Despite efforts to regulate the industry, significant gaps persist in ensuring the quality and safety of pet food in China. While regulations such as the “Regulations on the Management of Pet Feed” have been implemented, enforcement remains a challenge.

Addressing these challenges necessitates a multifaceted approach involving stringent enforcement of regulations, enhanced transparency within the industry, and heightened consumer awareness. Industry stakeholders must collaborate to establish robust quality control mechanisms and hold accountable those who ignore regulations.

Sam's Club's online sales account for nearly half of its physical supermarkets

The importance of instant delivery in the retail industry has become even more prominent. On April 16, the Beijing Business Daily learned that Sam's Club ("Sam's") had achieved sales of about 80 billion yuan in 2023, of which online sales account for 47%, very much the same level as its offline sales. This shows that the role of instant delivery business is gradually changing from value-added services to necessary supporting functions of enterprises. However, the cost of laying out an instant delivery system is high. At the same time, the cost of delivery, packaging and timeliness are all factors that companies need to balance. The analysis points out that instant delivery services are becoming an important part of retail enterprises, but in order to obtain good returns,

enterprises need to carefully calculate the cost account.

The proportion of online sales in the performance of retail companies is increasing. According to public information, Sam's will achieve sales of about 80 billion yuan (\$10 million) in 2023, with online sales accounting for 47%. As of now, Sam's has a total of 48 stores across the country. If it is assumed to be evenly divided according to the number of stores, this means that the sales of each store in 2023 will reach 1.67 billion yuan (\$230 million). According to the calculation of the number of members previously announced by Sam's 4 million, the average consumption of each member in Sam's will reach about 20,000 yuan (\$2,760) in 2023.

In the fourth quarter report of fiscal year 2024 released by Walmart China, it also shows the strong performance of Sam's and e-commerce businesses. According to the report, in the fourth quarter, Walmart China's gross profit margin was relatively stable, and the cost of e-commerce distribution was further reduced. Driven by sales growth, higher Sam penetration and efficient operations, overall operating rates decreased and operating income increased. Walmart's e-commerce penetration rate in China is 48%.

In the third and second quarters of fiscal 2024, Walmart China said that "Sam's business and e-commerce business continued to perform strongly", and in the first quarter, Walmart China's e-commerce business net sales increased by 54%. It is undeniable that the contribution of online sales to Sam's performance is gradually increasing, and its importance is further highlighted.

Not only Sam, but also many retail companies have gradually improved their online performance. Alibaba pointed out in the second quarter report of fiscal 2023 that Alibaba's direct sales and other revenue increased by 6% year-on-year to 64.725 billion yuan (\$893 million) during the quarter, mainly due to the strong growth of Hema revenue, and its online order revenue accounted for a high level of more than 65%. In 2022, Yonghui Superstore's online sales increased by 21.37% year-on-year, accounting for 17.69% of total revenue, and in the first quarter of 2023, its online business sales reached 4.02 billion yuan (\$555 million).

Discount retailers making mark among price-conscious bargain hunters

Product discount campaigns are emerging and showing promising development trends, becoming one of the hottest topics in the retail sector amid declining performances among hypermarkets and soaring sales in high-end membership stores, said industry experts.

Local retailers are also actively exploring and experimenting with discount stores. However, whether retail discount operations will become a strong force

in China's future consumer goods and services sector remains to be seen, said Wang Hongtao, deputy secretary-general of the China Chain Store & Franchise Association.

Wang said the association has observed the significant challenges facing the supermarket industry in recent years.

In January, the CCFA conducted a survey on the overall performance of regional supermarkets in 2023, covering over 10,000 stores involving more than 40 companies. The survey found that only 41.8 percent of supermarkets achieved positive sales growth in 2023, which was a slight decrease from the 44.3 percent reported in 2022.

"The retail industry is undergoing a period of significant transformation, with local supermarkets adopting cautious strategies such as closing unprofitable stores, slowing expansion and enhancing internal management," said Wang.

On the other hand, high-end membership stores like Sam's Club and Costco continue to open new stores in first and second-tier cities, achieving record-breaking sales per store, Wang added.

In recent years, discount stores have played an important role in retail industry trends in Japan, Europe and the United States.

Zhang Qiang, founder and CEO of Hitgoo, a retail discount chain, said in China, the next decade will also be a decade of discount store expansion. The discount store model, mainly focusing on daily necessities and foodstuffs, can be successful in the domestic market and presents certain opportunities, said Zhang.

Hitgoo plans to serve 120 million customers and achieve sales of 38 billion yuan (\$5.28 billion) in the next three years. In 2023, Hitgoo's sales reached some 8 billion yuan, and it plans to achieve sales of around 10 billion yuan by the end of 2024.

Lin Yongqiang, chairman of Guanpark Supermarket based in Fujian province, said their stores adopt a hard discount format, with each store having a standard operating area of 300 square meters, offering 2,000 kinds of products, focusing only on standard products, without bulk and fresh goods being prioritized.

Guanpark discount stores are more simply decorated and have low labor costs due to shortened circulation processes and restructuring of supply chain relationships, Lin said.

He said that whether hard discounts or soft discounts are on offer, ultimately, discount stores are about efficiency — who is more efficient and who is less so — in terms of supply chain efficiency and operational efficiency.

Chen Liping, a professor at Capital University of Economics and Business, said the notion that "all supermarkets in China should transition to discount stores" is a misconception.

"Different consumers have different preferences, and enterprises should provide appropriate quality products to meet consumer needs," Chen said.

Chen suggested that the retail industry should address issues such as the aging population, smaller households, the rise of single-person households and the loss of commercial populations in rural areas, by creating value for consumers.

Looking at the future development of Chinese supermarkets, Chen said strategic management will become the most important factor determining the survival of enterprises.

In a market environment characterized by economic downturn, sluggish consumption and an aging demographic, retailers need to reposition their target markets and be able to understand customer needs and convert them into products that create value for customers, he said.

In an environment of a graying population and declining birth rates, product cost-effectiveness and time-cost effectiveness are basic requirements for consumers of all income levels, said Chen.

While food discount stores are developing rapidly, value-oriented supermarkets will become the mainstream of the market, and the key to the development of value-oriented supermarkets lies in their ability to develop products that fit evolving lifestyle needs, Chen said.

As traditional distribution systems gradually evolve, supply chain ecosystems will shift toward more win-win cooperation, he added.

Thank You!

Submitted by SMH, China/Hong Kong In-market Representative

