The current year started out as a tough one for the Chinese meat sector. In spite of this, China's meat industry is on the road to recovery and consolidation.

By Paul French

"Sorry, we have no chicken"

The onset of avian flu made it look likely that the damage already done to the Chinese food industry during SARS would deepen. By the end of January, ten countries in south, southeast and north Asia reported cases of the virus, including China. Suddenly poultry stalls in China's wet markets were closed down (many never to reopen), chicken disappeared from menus across China and, perhaps most importantly, Chinese diners stopped ordering chicken. For those that still wanted to eat poultry the often-heard response was 'Sorry, we have no chicken'.

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However, as soon as bird flu disappeared it seemed the scare receded. Once seemingly contained it wasn't long until things were mostly back to normal. Previous experiences of avian flu in Hong Kong and southern China have suggested that food scares do not affect sales for long. After an outbreak of bird flu in 1998 chicken was soon back on the menu and even after the outbreak of SARS in 2003 local people quickly resumed consumption of wild animals following the passing of the first outbreak despite government controls and warnings about the consumption of civet cat in particular.

Disaster strikes

At the time avian flu appeared disastrous. It seemed that the plans of many foreign producers to get more involved in China were doomed. Over the past few years China has tightened restrictions on poultry imports, limiting the number of authorised importers and the amount of produce that they are permitted to import. Invariably, requested import amounts are cut by two thirds or more by the authorities. China was also quick to impose bans on imports from other countries affected by bird flu, including the US (in February two birds tested positive for a strain of bird flu on a farm in Delaware) as well as finding that Chinese poultry was banned from export. Though the outbreak adversely affected chicken sales, US sales to China were falling even before the ban on US imports was imposed due to quota limitations.

Economies of scale

However, once the emergency was over it became increasingly apparent that in actual fact the larger poultry firms were best placed to weather the storm. Companies establishing themselves in China, including global names such as Tyson and Perdue, were better positioned than many local firms due to their superior hygiene standards. The crisis appears to have actually had the effect of speeding up the trend of recent years in which medium-sized producers began losing market share to larger broiler meat-processing companies and for local clients to increasingly buy from larger producers. China's poultry processing industry may be the second

Retail sales of meat by type in China, 2002-2003			
	2002	2003	Percent growth
Pork	13,129.20	14,248.70	+8.5
Poultry	3,426.40	3,656.10	+6.7
Beef and veal	1,625.90	1,811.90	+11.4
Lamb, mutton and goat	1,110.30	1,233.60	+11.1
Other meat	1,818.40	2,005.00	+10.3
Total fresh meat	21,110.30	22,955.30	+8.7

Meat volume retail sales ('000 tonnes)

Source: Access Asia

largest in the world (after the USA) but it is labour intensive, employing hundreds of thousands of people working in small poultry farms spread across the country, many of which are technically bankrupt and fall below international hygiene standards. However, in some sense the highly dispersed and erratic nature of the Chinese poultry industry - compared to the more concentrated industries of other Asian countries, such as South Korea, Vietnam and Thailand - may have stopped the spread of avian flu and saved many farms in China from total eradication.

Affected farms and culled poultry represented a small fraction of China's total poultry bird stock, which now stands at 4.7 billion, according to FAO. In another lucky break the first cases of bird flu in China were confirmed on January 27th, only days after the Chinese New Year - the peak sales period for the local poultry industry. This has meant that in areas where flocks have been culled or sales prohibited, losses were much lower than they would have been just a week earlier. Consequently many direct losses were limited because the farms hadn't started up new flocks.

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Big foreign players

While the avian flu problem continued the major international meat processors pressed on regardless in China. Recently Perdue Farms successfully acquired the bankrupt assets of Feng Huang Poultry Slaughterhouse in eastern China's Anhui Province close to the major metropolitan market of Shanghai. While Perdue is moving more into the slaughtering business, their US rival Tyson is looking increasingly at the fast food and catering market in China as a source of long-term and more predictable business.

With a combination of improving health standards, tougher government-imposed hygiene regulations, more competition and a shift towards larger broiler processing companies the future for many smaller, dirtier and decidedly antiquated Chinese processors is looking increasingly tough. So far companies like Perdue have benefited from this process by picking up bargain acquisitions. More bankrupt local firms are expected to follow though hopefully no more examples such as the Shenzhen-listed domestic meat processing company New Chundu Group who's Chairman Liu Haifeng was arrested in April after having "disappeared" for several weeks and forcing the company to issue a statement saying it had "lost contact" with him. Liu is now under arrest in Henan Province on embezzlement charges. It goes without saying that foreign meat processing companies would do well to learn an important lesson from the corporate governance experience at Chundu Group and take the time to carefully choose their partner in China. Foreign meat companies can't be too careful - Chundu had after all managed to obtain a domestic stock market listing.

Prohibitive prices

Other foreign firms in the meat processing business have also found that, even if they can locate their chairman, fluctuating costs and the possibility of more disease outbreaks can be problematic. China-based Singaporean meat processing company United Food Holdings reported that its first quarter 2004 profits fell 42%, partly due to bird flu but also due to higher prices of raw materials such as corn, soybean and live pigs. Other companies, both domestic and foreign, that are looking to process and then export from China have found rising prices and disease a problem. For instance, Shanghai Dajiang Meat Processing Plant No 2 is one large local firm that has suffered from the perception of China as being prone to avian diseases. Fully 90% of Dajiang's meat exports go to Japan, which banned imports from China during the avian flu outbreak in January. Though Japan

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has partially lifted its ban on hot processed poultry meat, Dajiang has suffered this year. Other local firms have not been as fortunate as Dajiang, whose license has been restated, as Japan only permitted 35 Chinese companies to resume exports of hot processed poultry meat to Japan. The effect is significant. Last year, China exported cooked poultry meat worth US$510 million, of which US$426 million (or 85%) was shipped to Japan.

With costs of livestock, land and feed rising in China and the country now suffering from a poor hygiene record after SARS and bird flu, some major manufacturers who have concentrated on China until recently have started to look elsewhere. For example Hormel USA is establishing a processed meat manufacturing plant in partnership with Philippines food and beverage giant San Miguel in Dong Nai province, Vietnam. San Miguel has an investment license in Vietnam so Hormel fortunately doesn't need an alliance with a Vietnamese manufacturing company. San Miguel also recently bought Taiwan Tea Corporation's 100% stake in TTCV Investment (BVI) Company Ltd., a firm engaged in pig farming and feed milling in Ho Chi Minh City (Saigon) which includes a hog farm and a feed mill in Dong Nai province employing about 500 workers. Business costs in Vietnam are now lower than China and the country offers GDP growth of 6-7%, a domestic market of 70 million people and improving export facilities to neighbouring China and throughout southeast Asia – all extremely attractive factors to Hormel.

Back on the shelves

Meanwhile, the retailing of meat in China is steadily improving – a process that is being speeded up since the outbreak of bird flu. An immediate consequence of the outbreak was that many market stalls where hygiene was less than brilliant have been shut down – seemingly permanently in many cases. This is part of the overall shift in the major cities away from traditional wet market retailing to boosting the business for supermarkets and hypermarkets. Many local people complain as wet markets become fewer and further between, they don't always have a local supermarket and prices are higher while supermarket shopping is not always suited to a culture where daily food shopping is still the norm for over 50% of the urban population.

However, French fresh food supermarket operator Champion has introduced a new way of retailing to China with the opening of its first Chinese (indeed Asian) outlet in the Beijing suburb of Jinsong. At 3,000 square metres the supermarket is large by Chinese standards. Champion, part of the Carrefour group which is already well established across China, specializes in selling fresh food and is concentrating its China branches in residential communities partly to take up the slack the demolition of wet markets is creating. Champion benefits from sharing purchasing resources with Carrefour and through a joint venture with Beijing Shoulian (Capital Allied) Commercial Group. The company predicts that fresh meat in hygienic conditions will be a major draw to the store.

Don't forget the niches

While importing chicken remains restricted forcing the likes of Tyson and Perdue to increase their operations directly in China, some niche sectors are booming. In 2003 the US was the world's top supplier of chicken feet to China, with an estimated 8 billion feet shipped. Chicken feet are considered a delicacy and sold in restaurants, stores and street-side kiosks throughout China. While in Europe and America chicken feet are largely discarded, China is currently suffering an acute shortage pushing up prices. In February when the Chinese government halted imports of American poultry the chicken feet business halted abruptly and US poultry farms had to grind the feet into pet food instead, a far less lucrative market. With the ban lifted then the feet will start being shipped to China again. Clearly there is a big difference in what a renderer will pay for what is essentially a by-product and what Chinese importers will pay for what is a delicacy.

China, as ever, offers great opportunities for meat producers, processors and renderers yet, also as ever, the pitfalls of operating in China can be greater than the anticipated profits. **MI**

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