



Ingredients Success In China

China holds huge potential for food ingredients suppliers - if they can navigate the regulations



Food ingredients
Asia-China

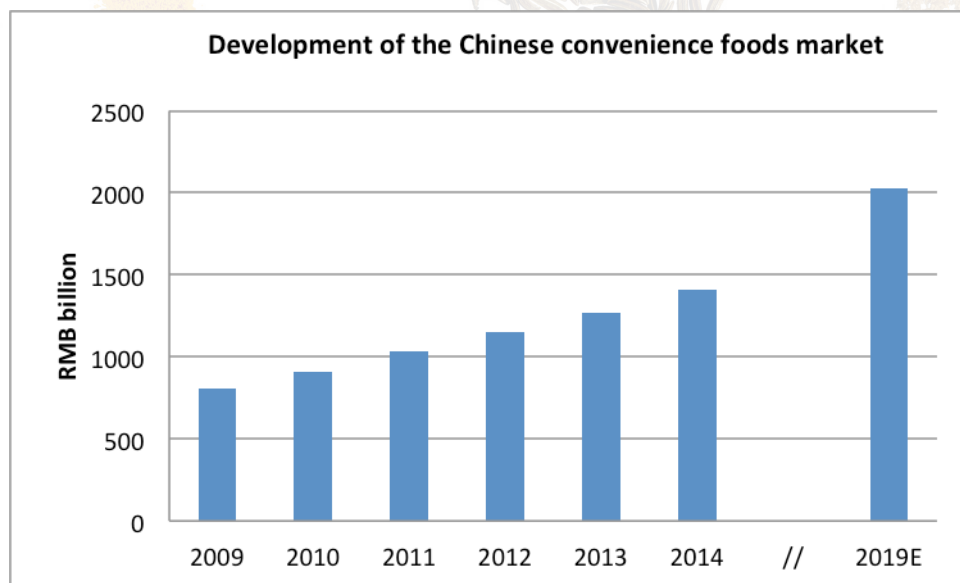


Health ingredients
China
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Introduction

The promise of premium packaged food

The Chinese convenience food market is the largest in the world, estimated to be worth RMB 1409 billion in 2014¹. Although economic slowdown has put the brakes on the extraordinary growth rates of 12% CAGR² seen between 2009 and 2014, annual growth of 8% is still expected over the next few years. By 2019 it is expected to reach RMB 2028 billion.



Source: Euromonitor International/Fiducia Management Consultants

The key consumer group behind this growth story is the urban middle class, with high disposable incomes. This all-important group is seeking more convenient, easy to prepare foods that fit in with a busy lifestyle. The slowdown might have led some to buy less packaged food volume-wise, but many are trading up to premium products. A spate of high profile food safety crises made a serious dent in consumer confidence; 71% of respondents in a 2015 Pew Global Attitudes Survey considered food safety to be a 'very big' or 'moderately big' problem³. Consequently, there is considerable interest in natural, clean label and organic foods.

Foods imported from the West tend to have a food safety 'halo', particularly if they hail from the US or Australia, which are perceived to have high standards. Europe is also seen as a source of clean and safe food, if more industrial than Australia⁴. Rapid development of cross-border e-commerce, alongside 'bricks and mortar' retail outlets, means Chinese consumers can easily access foods from other countries.

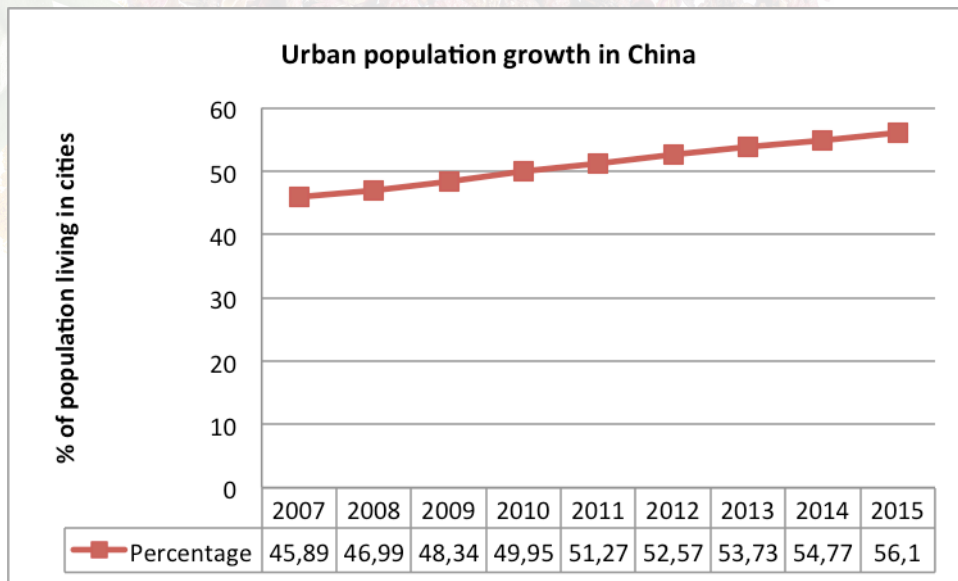
Chinese consumers are also increasingly educated about — and interested in — healthy eating.

¹ Euromonitor International/Fiducia Management Consultants

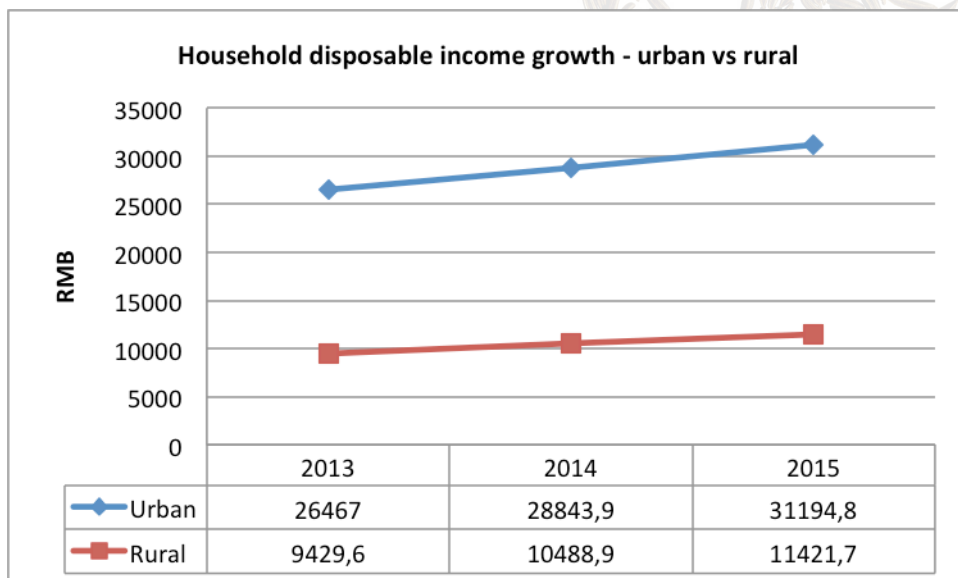
² Compound Annual Growth Rate

³ <http://www.pewglobal.org/files/2015/09/Pew-Research-Center-China-Report-FINAL-September-24-2015.pdf>

⁴ Qualitative research conducted by The Silk Initiative



Source: China Statistical Yearbook 2016



Source: China Statistical Yearbook 2016

For example, instant noodles, a convenient mainstay of the Chinese diet, are rapidly falling out of favour; sales have declined by 12% to RMB 82 billion since 2013, with a further slump to RMB 62 billion anticipated by 2021, as consumers are opting for lower-fat, more nutritious Western

style convenient foods instead⁵. Moreover, the new 'Chinese dietary guidelines' released in May 2016 advocate a varied diet including cereals, fruits, vegetables, milk and soybeans, reduced consumption of salt, oil and sugar, and appropriate quantities of fish, poultry, eggs and lean meat.

⁵ Euromonitor International

Opportunities for ingredients companies...

These trends represent considerable opportunities for international specialty ingredients companies. Suppliers of natural, clean label and plant-derived ingredients are finding the market particularly keen for their wares, as are those that supply ingredients that enable healthier food formulations such as reduced sugar, salt and fat, and even functional ingredients with added health benefits. Dairy ingredients, too, are proving popular; despite high levels of lactose intolerance in the Chinese population, demand for dairy is dramatically outstripping domestic supply⁶.

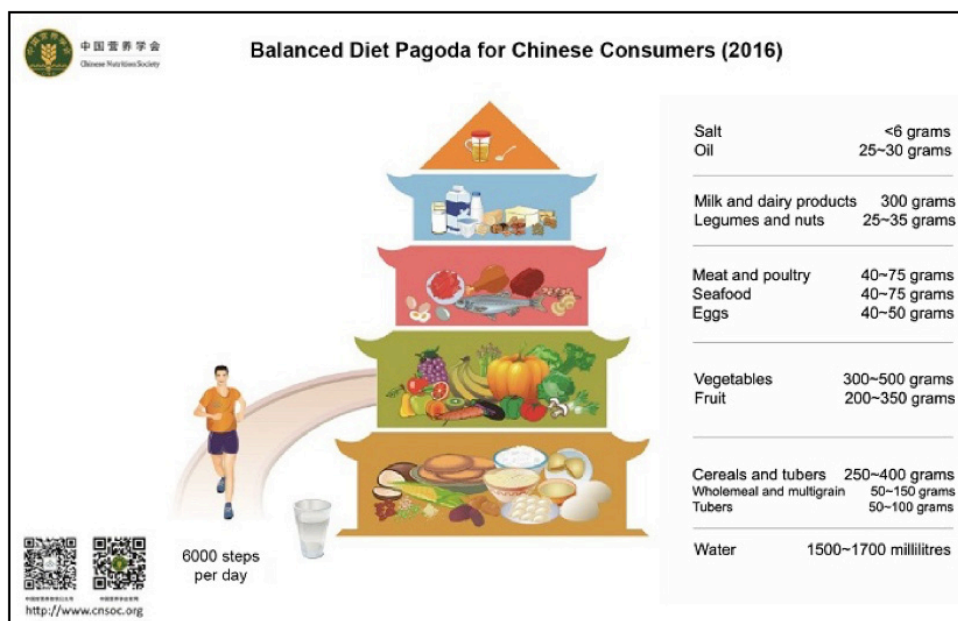
Many multinational food manufacturers already have a strong presence in the Chinese market, and are obvious key accounts for international ingredients companies. But domestic manufacturers, too, are looking to up their game and are interested in catering to the demand for high quality, premium foods, not least to stem profit losses as the coveted middle-class turns its back on traditional foodstuffs.

...and challenges

Doing business in China is not always easy, however. It is a vast country with diverse regions, and very different consumer cultures and tastes — not just between urban and rural consumers, but between those in different provinces and in cities of different sizes and characters too. Some cities — such as Shanghai, with a population of over 25 million — are the size of small countries in their own right!

The business culture can also be quite alien to companies entering China for the first time that lack the all-important *guan-xi* (connections) that underscore relationships, including dealings with regulatory authorities.

But most significantly, if international ingredients companies are to take advantage of the opportunities offered by the Chinese food industry there is a vital need to understand the regulatory landscape. They must ensure ingredients are fully compliant and that procedures are followed to the letter. Failure to do so could result in expensive and brand-damaging problems, such as shipments being turned away at ports, product recalls, and severe penalties.



Source: Chinese Nutrition Society (reproduced with permission)

⁶ <https://www.foodnavigator-asia.com/Article/2017/10/30/Yoghurt-soars-as-China-develops-new-dairy-foothold>

A regulatory landscape in flux

Food Safety Law 2015

The most significant law for food ingredient companies doing business in China is the new Food Safety Law (FSL)⁷. The new law, which came into effect in 2015 after several years of drafts and consultations, was deemed necessary in the wake of high profile scandals and the need for China to keep step with international food safety management practice. It is the country's most stringent food legislation to date, and the Chinese government — from the highest echelons — has made it unequivocally clear that food safety is a national priority.

The FSL introduces new regulatory requirements for foods, food additives, and food-related products (such as packaging, containers, detergents and disinfectants). It covers every stage of food production, storage, distribution, sale and recall, and takes account of new modes of trading, such as e-commerce. There are special requirements for contentious areas of the food industry, or those that have been involved in high profile food safety incidents.

Considerable onus is placed on food producers and traders to comply with the new requirements, and penalties for contraventions are harsh. In addition to criminal liability, fines can be up to 20 or 30 times the monetary value of non-compliant products.

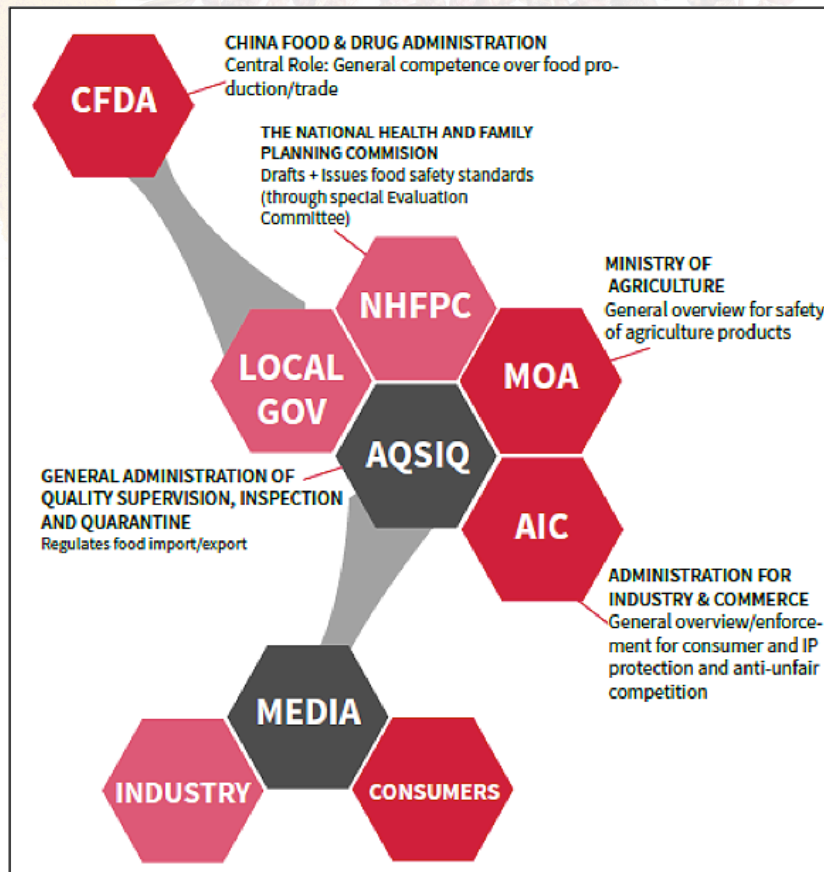
Who's who in Chinese food safety

The FSL formalizes the food safety system introduced in 2013 (see diagram on next page). The China Food and Drug Administration (CFDA) under the State Council plays a central role in supervising food production and trade. Other agencies have specific responsibilities for, for example, issuing food safety standards (NHFPC) and regulating food imports and exports (AQSIQ), while local governments are to oversee food safety within the administrative regions.

The FSL also establishes a 'whole society approach' to food safety, with industry, the media and consumers all expected to play their part.

⁷ Unofficial English translation https://www.hfgjp.com/sites/default/files/law/food_safety_-_16.02.2016.pdf

Institutional players in China's food safety system



Source: HFG Law and Intellectual Property (reproduced with permission)

Implementation challenges

The new FSL took effect on 1 October 2015 and provides a basic legal framework for a shored up food safety system that will help re-build consumer confidence. The affiliated Food Safety Law Implementing Regulations will fill in the details; as of December 2017 three drafts have been published for public comment but the final version has not been approved⁸. Moreover, a raft of related regulations, standards and administrative measures — some new, some amended from previous versions — have been published for public comment, but many have yet to be finalised. The unfolding implementation must be followed closely, to ensure there are no inadvertent violations.

Despite the pending regulations, however, it is already clear that food ingredient suppliers will have to bear the cost of compliance with the new standards and procedures. These costs are likely to pose major challenges for small suppliers. It is anticipated that some consolidation will occur in the highly fragmented domestic food industry which, as of March 2015, was made up of 193,879 food production enterprises and 3432 food ingredient and additive manufacturers, according to the CFDA⁹. Indeed, market consolidation is expected to make food safety enforcement in China more manageable for the authorities.

⁸ A third draft of the implementing regulation was submitted to the WTO on August 14th 2017.
<http://myemail.constantcontact.com/CFDA-Submits-to-WTO-the-Third-Revised-Draft-Regulation-on-the-Implementation-of-the-Food-Safety-Law.html?soid=11116651795207&aid=Sa6S0vtKLHs>

⁹ https://gain.fas.usda.gov/Recent%20GAIN%20Publications/Food%20Processing%20Ingredients_Beijing%20ATO_China%20-%20Peoples%20Republic%20of_9-4-2015.pdf

Moreover, certain procedural aspects of the FSL, implementing regulations and standards will present challenges to foreign suppliers wishing to do business in China. For instance:

- Overseas producers and exporters are responsible for ensuring that products are fit for market; Chinese importers have an obligation to verify that this is the case¹⁰. This means that food companies with facilities outside China producing certain products, such as infant formula, food for medical purposes, health foods, and meat products, must submit to an audit by Chinese food importers at least every three years.
- Imported foods are to be accompanied by an official certificate from the authorities in the exporting country to confirm that the food is manufactured under proper government supervision and is suitable for human consumption¹¹. This represents a burden for exporters as the requirement applies to all foods irrespective of the food safety risk — and for many governments that do not currently issue such documents for specific products or shipments. There is some respite, however, as in September 2017 AQSIQ announced a two-year transitional period for implementation of the controversial requirement, to September 30th 2019.
- A new, simpler notification system is established for health foods falling under the category of vitamins and minerals, which is intended to ease the burden on industry of pre-market registration¹². However, only the vitamins and minerals that are in the approved catalogue (first batch) are currently eligible for notification. All other health foods, whether they are imported or locally manufactured, must go through the lengthy and expensive registration process. Once the dossier has been submitted by the foreign company, the assessment phase involves several tests, inspections and evaluations by CFDA, which need to be handled by a domestic Chinese entity¹³.
- A new licensing system for food production and trade, including for production of food additives, has been introduced¹⁴. There are numerous sub-categories of licenses with specific standards and regulators for different activities, as well as specific licenses for different types of food (e.g. pre-packaged food, health food, hot food)¹⁵. All food companies — both domestic and foreign — must navigate this system to ensure they have the correct licenses for their intended activities.

¹⁰ Food Safety Law, article 94

¹¹ Administrative Measures on General Certification of Imported Food

¹² Regulation on the Registration and Notification for Health Foods

¹³ More details can be found in China Regulatory Matters published by Keller and Heckman LLP, see e.g., <https://www.khlaw.com/China-Food-Law-Year-in-Review-2016>.

¹⁴ Measures for the Administration of Food Production License and Measures for the Administration of Food Operation Licenses (since changed to Food Sales and Catering Service License)

¹⁵ <https://chinafoodlaw.blog/2017/09/30/which-food-licenses-for-your-business-model/>

The regulatory agencies are flexing their muscles to ensure compliance with new standards and procedures. For instance, AQSIQ announced that 233 batches of imported food were turned away at port in September 2017, 67 of which were due to levels of additives (including caffeine, cochineal, curcumin, and vitamins B1 and B2) exceeding those permitted in the Chinese National Food Safety Standard for the Use of Food Additives, last amended in late 2014 (GB 2760-2014)¹⁶.

Another challenge is that, despite the establishment of CFDA and attribution of responsibilities to other agencies, there are still reports of the different agencies issuing conflicting information, causing a headache for the industry. Moreover, as well as the central implementing regulation, local governments are also developing new

implementing rules. Different rules — and even disparities — cause problems for importers and international businesses that import food through different ports¹⁷.

Another issue that has troubled many companies in the food industry is the newly arising concept of the 'professional consumer'. Professional consumers seek to identify products that they believe may not comply with applicable laws and regulations, and purchase them in significant quantities in the expectation of being awarded punitive damages worth several times more than the purchase price. Many such claims are unfounded, yet food manufacturers and operators bear the costs of defending against them. Usually the outcome does not actually improve food safety¹⁸.

¹⁶ <https://chinafoodlaw.blog/2017/10/20/additives-beware-of-chinese-regulations>

¹⁷ <https://foodindustry.asia/china-new-food-safety-law-the-realities-of-practical-implementation-since-promulgation>

¹⁸ <https://www.khlaw.com/Handling-Professional-Consumers-A-New-Challenge-to-Doing-Business-in-China>

Other relevant laws and regulations

● E-commerce Law (second draft for comments November 2017)

Covers both domestic and cross-border e-commerce, establishing the responsibilities of platform providers and operators. There is considerable focus on intellectual property, competition, electronic contracts and payment, logistics, data treatment, consumer protection, and the need for a contingency plan in a security event. The law establishes that e-receipts and certificates have same legal status as paper ones, to increase digitization and convenience in customs clearance, tax collection, inspection and quarantine.

● Food Safety Fraud Investigation Regulation (draft for comments February 2017)

Provides a broad definition of food safety fraud as the intentional provision of false information or intentional concealment of true circumstances within activities of food production, food storage, food transportation, food sale, catering, etc. Sub-categories by behaviour include: product fraud; food production and business operations fraud (including non-compliant food for children, use of non-food or expired ingredients); label and instructions fraud (including composition, non-certified organic claims); food advertising fraud (including treatment/curative claims); etc. Many of these behaviours are also covered in other legislation, but the new regulation provides additional sanctions.

● Advertising Law (2015)

Establishes that the role of advertising is to inform, not mislead. Articles directly concerning food state that products may not include recommendations by food safety agencies or food industry associations; may not exploit the title or image of a doctor, use medical jargon, or make disease or treatment claims; and must comply with public health regulations. Ordinary (non-health) food can make nutritional claims (eg low sodium) if compliant with relevant legislation, and there are specific regulations for certain products such as baby food and alcoholic beverages. Celebrity endorsement is permitted, but the individual may be held responsible if the product is ineffective.

● Administrative Measures on Certification of Organic Products (2013)

Requires any foods bearing the word 'organic' — even in English — to be certified by the China Quality Certification Centre (CQCC). Many imported products are sold with a sticker over the word organic, but this raises consumers' suspicions. Consequently, more and more foreign brands are applying for CQCC organic status.

● Agricultural Product Quality and Safety Law (2006)

Governs the quality and safety management of edible primary products sourced from agriculture — although the marketing of edible farm produce, the development of quality and safety standards, the release of safety information, and agricultural inputs fall under the scope of the FSL.

Strategies for entering the Chinese food ingredients market

1) Do your research

Do not underestimate the size, diversity, and fragmentation of the Chinese packaged food market. Considerable research is needed in order to identify target consumer groups and regions, and to fine tune your strategy. Attending key industry events, such as FIAC 18 and HIC, will enable you to keep abreast of trends and market needs. It may also be helpful to commission bespoke market research.

"Do not underestimate the size, diversity, and fragmentation of the Chinese market. It is huge, with a population of almost 1.4 billion, and there are big differences between cities and provinces, and between rural and urban areas."

Paul Collins, director of international sales and marketing, GNT Group

"Trade shows are very important for new companies in China, especially SMEs. They are helpful for obtaining feedback from Chinese people, and also for finding partnerships. There is a lot of value in networking with potential clients and competitors and learning professionally."

Joel Bacall, senior client manager, The Silk Initiative

2) Work with a distributor — and be sure they are right for you

While you may be able to work directly with multinationals if you have an existing relationship outside of China, to reach domestic food manufacturers you are likely to need a local distributor. You may even need more than one if you are targeting several different regions. It is crucial to shop around for the right agent, who has the desired reach and contacts. As some local companies over-promise on the guan-xi (connections) they can provide, do your homework on their claims. A distributor must also have values that are similar to your company's; they need to be able to provide the same quality of service as your own salespeople.

3) Learn about Chinese culture

Even if you partner with a local agent there will still be occasions when you will need to engage directly with clients. It pays to learn about Chinese culture and to be willing to adapt to new ways of working. Having some Chinese employees in your team can be instrumental in navigating cultural and language difficulties.

Strategies for entering the Chinese food ingredients market - cont.

4) Work with a regulatory consultancy or law firm

However much you mug up on Chinese food law, you won't be an expert overnight — especially when the legal framework is undergoing significant changes. A dedicated consultant will help you to navigate the complexities of compliance and will be able to draw on experience gained in previous, similar cases. They should also have good connections within the regulatory agencies, so they can obtain accurate information when required.

5) Engage with trade associations

Trade associations can help ensure you have a voice over important industry issues. Even if you do not take out company membership, your agent should certainly be a member of the relevant Chinese association for your business (see box below) — and you can still engage in dialogue over issues that affect your business. For instance, GNT was one of several ingredients companies that worked with China National Food Industry Association to develop a new group standard for clean label 'colouring foods' (from fruits, vegetables, plants and algae). Although it is not a legal definition as such, the group standard — which has been formally implemented since January 1st 2018 — provides regulatory certainty and clear criteria for the definition of colouring foods.

"The new Group Standard is a definite advance for colouring foods in China since it provides support for products with colour solutions that consumers readily accept and recognize to be natural. It eases the life of manufacturers in replacing additive colours with clean label solutions and meeting growing consumer demands for more naturalness."

Victor Foo, general manager of GNT Singapore.

Food industry associations in China

China National Food Industry Association	www.cnfia.cn
China Grain Association	www.chinagrains.org.cn
China Sugar Association	www.cas.gov.cn
China Alcoholic Drinks Association	www.cada.cc
China Beverage Industry Association	www.chinabeverage.org
China Bakery and Confectionery Industry Association	www.china-bakery.com.cn
China Dairy Industry Association	www.cdia.org.cn
Dairy Association of China	www.dac.org.cn
China Meat Association	www.chinameat.org
China Cereals and Oils Association	www.ccoa.info
China Canned Food Industry Association	www.cncfi.com
China Candy & Confectionary Association	www.tangguo.cfiin.com

Acknowledgments

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The information provided here was compiled with due care and up-to-date to the best of our knowledge on publication. Please note that the regulatory landscape in China is developing rapidly and the information provided here is subject to change.