

Coffee brews a future in China?

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Coffee marketers are working on transforming China “the homeland of tea” to a coffee drinking nation. Coffee remains a statement of fashion although consumption is growing rapidly. Hope Lee from Euromonitor reports.

Starbucks is suing a rival local Chinese chain (Shanghai Xingbake Co) whose name in Chinese characters is virtually identical to that of the U.S. giant that introduced coffee culture to a nation of tea lovers. The global spread of coffee-houses is touching down in China, with coffee consumption increasing year after year. Euromonitor, the world’s leading market intelligence provider, reports on the latest trends in coffee consumption in the homeland of tea.

Domestic production expands

Total volume sales of coffee in China grew by nearly 90% between 1998 and 2003, to 6,504.5 tonnes. Domestic production of coffee beans also expanded rapidly. China Agriculture Yearbook reports that China produced a modest figure of 3,573 tonnes of coffee beans in 1997, but by 2000 this had risen to 11,568 tonnes. The United States Department of Agriculture (USDA) estimated that this figure had risen to 13,000 tonnes by 2001.

The expanded local production of coffee beans coupled with the low price of green coffee in international markets has contributed to the reduction of the retail price of coffee in China. This situation encouraged investment in coffee, which in turn resulted in a higher visibility in the retail market, particularly in large cities. The level of publicity and media interest in coffee also notably increased.

Coffee consumption - a cosmopolitan lifestyle

Coffee is a Western concept to most Chinese consumers, who associate it with Western lifestyles. Unsurprisingly, coffee consumption in China is highly concentrated in large cities such as Beijing, Shanghai and Guangzhou. Coffee appeals to adventurous, open-minded, young, affluent, urban consumers. These consumers are more exposed to Western influences and tend to look up to Western lifestyles. Manufacturers have targeted Westernised young professionals as the main target market for coffee. The key issue is how to convince these consumers that coffee is a beverage to be drunk regularly rather than just a passing fad.

Another large consumer group, which influences the coffee consumption, is returnees. China has seen an influx of returnees (mainland Chinese students returning from Western countries) over the last five years. Many of these returnees have lived in Western countries for a decade and they have become accustomed to the coffee culture. Upon their return to China they have carried on living in this fashion. Visiting cafés and drinking coffee at breakfast is not a novelty for these consumers. Their strong earnings mean that they can afford to pay a premium price for a lifestyle to which they aspire.

Foreign ex-pats also comprise a large proportion of coffee consumers in China. China’s high growth economy and improved investment has attracted substantial foreign direct investments, which has led to rapid increases in the number of ex-pats. Shanghai’s official statistics show that the number of Taiwanese living in Shanghai for short periods (at least three months) is estimated at 230,000. The figure is expected to increase each year. Ex-pats are at the high-end of coffee consumption and are also regular patrons of cafés. It is reported that Westerners and businessmen from Hong Kong and Taiwan represent 30% of customers at chained cafés such as Starbucks.

Instant coffee leads the way

In terms of market composition, instant coffee dominates the Chinese coffee market. In this tea-drinking nation, coffee culture is just starting to touch down. Most Chinese do not fully appreciate the taste of coffee and they are content with the taste of instant coffee.

The popularity of instant coffee can also be attributable to its convenient preparation. This appeals particularly to white-collar workers who have busy lifestyles and cannot afford the time to prepare fresh coffee. Price-wise, fresh coffee is expensive when compared with instant coffee. Additionally, the availability of fresh coffee is highly limited. It is found only in select stores and expensive foodservice establishments and hotels.

The convenience of 3-in-1 instant mixes (coffee, milk powder and sugar) has resulted in robust growth in volume sales. However, coffee mixes do not contribute much to overall value growth due to their low price.

Starbucks: a representative of on-trade channel

China doubled its on-trade coffee consumption between 1998-2003. This is a mostly urban phenomenon with most rural areas largely untapped. On-trade sales of coffee mainly go through three types of establishments: coffee shops/café's (independent and chained), Internet café's and fast food restaurants.

Euromonitor's figures show that chained coffee shops, such as Starbucks and Manabe (Japanese style café), saw spectacular growth in unit sales, up by 814% between 1999 and 2003. Starbucks stands as a statement of modern lifestyles and affluence in today's China. The company has opened over 90 outlets in the country.

However, Starbucks faces increasing competition from other foreign players. China's accession to the WTO has led to the gradual relaxation of the policy governing foreign owned retail outlets, and will lead to more foreign investment and new market entrants. The reduction of import tariffs on coffee will also encourage foreign investment in coffee. Canadian chain Blenz Coffee for example, plans to open 50 outlets by the end of 2004 in China, where consumers can smoke on the premises. China, reportedly, has at least 200 million smokers. Blenz Coffee's move obviously serves to differentiate itself from Starbucks.

Local coffee shops seem unable to compete with Starbucks directly. While the local players are busy cashing in on the café trend, some imitate Starbucks' operations, which has caused uneasy experience. This is highlighted in the high profile lawsuit between Starbucks and Shanghai Xingbake Co. Starbucks is suing Xingbake (whose name in Chinese characters is virtually identical) for trademark infringement after the two sides failed to settle out of court. The court has yet to make a ruling. Starbucks cannot afford to lose the lawsuit, as Shanghai is the core market for its mainland Chinese operation. To gain a firm management control in China, Starbucks increased its stake in President Coffee Co. (a joint venture between Starbucks and the Taiwan based company Uni-President) from 5% to 50% in the middle of July 2004.

Nescafé has the first mover advantage

The Chinese coffee market is highly consolidated, with multinationals controlling the market. Nestlé was the first multinational to establish a coffee processing plant in China. Nestlé's Nescafé brand is a long-running favourite in the instant coffee sector in China and Nescafé has now become a generic name for coffee. In 2002, Nestlé accounted for 46% of retail value sales. The company runs continuous above-the-line and below-the-line marketing and promotional campaigns in the country. Kraft is trailing Nestlé considerably, holding a 20% share in 2002.

Multinationals have made a positive contribution to the development of the Chinese coffee industry with both Nestlé and Kraft utilising domestically grown coffee to supply the local market. Nestlé also sent technical staff to the Yunnan province (one of the major coffee-producing provinces in China) to help growers produce coffee beans which meet their own production requirements.

Exciting potential but a lengthy transformation period ahead

The Chinese coffee market is expected to grow by 70% in total volume sales between 2003 and 2008 to reach 11,073 tonnes. Euromonitor findings show that, within Asian countries, affluent consumers with a high degree of Western influence are more likely to accept a coffee culture.

Coffee consumption in Japan (1.4 kg per capita) and Singapore (1.9 kg per capita) are far higher than that in the UK (1.2 kg per capita). In the Greater China area, Hong Kong stood at 0.8 kg per capita, higher than the world's average at 0.7 kg. This is positive news for the Chinese coffee industry and coffee marketers are now working on persuading Chinese consumers to increase their coffee consumption significantly in the next two decades.

Concerted efforts have been made to promote coffee consumption within China. In 2001 the International Coffee Organisation organised coffee festivals in both Beijing and Shanghai. Some coffee marketers believe they can eventually persuade every Chinese citizen to drink a cup of coffee a year. If they succeed, this would translate into substantial market demand for coffee, thus benefiting local and international coffee manufacturers.

Despite the potential of a 1.3 billion population base, coffee marketers are wary of the difficulty in transforming a tea-drinking nation into a coffee-drinking nation. Tea is the Chinese national drink and will continue to be an integral part of Chinese daily life in the next two or three decades. Further to this, tea is seen as a drink, which has health benefits, while coffee is marketed as no more than a lifestyle drink. The price of coffee is still out of reach for the average Chinese consumer, while tea is a cheap indigenous product. Most Chinese consumers still have little or no knowledge about coffee. Therefore, the transformation hoped for by coffee marketers is not impossible, but it will not be easy and will not be rapid despite the recent growth.

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