

China's Emerging Markets: Opportunities in Logistics and Distribution

Thirteen of China's second-tier cities account for 8% of China's population but 53% of its total imports – which is why the untapped markets of China's emerging cities provide some of the most exciting and lucrative opportunities for U.S. exporters.

China's Real Economic Engine....

China's unprecedented growth and the opportunities it presents are no longer a secret to anyone in the business world. While megacities such as Beijing and Shanghai have long captured much of the spotlight, it is behind the scenes in second-tier cities where one can witness the *real* source of China's economic growth. Unlike what one might expect, the majority of China's imports are *not* ending up in Shanghai, Beijing, or Guangzhou. Rather, a select group of thirteen second-tier cities¹ account for an astonishing 53% of China's total imports, almost double the amount of the three megacities combined.

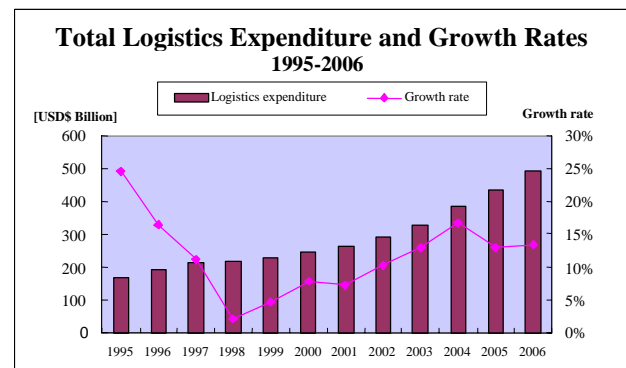
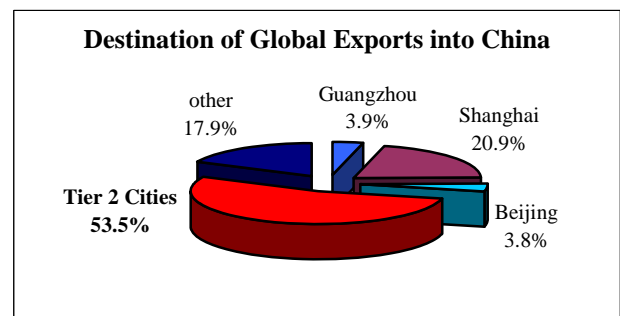
Local entrepreneurs in these emerging cities are not the only ones reaping the benefits. These cities have become importing havens and present lucrative opportunities, especially for US companies. Perhaps the critical question for American firms is not *whether* there is a second-tier city market, but *which* region is best for a particular industry or product.

Opportunities in logistics and distribution industry:

Market overview. China's logistics market grew at 13% annually in the last few years to reach a value of \$490² billion in 2006. However, less than 20% of the market is provided by 3PLs, which are characterized by low service levels and poor technology. The 3PL landscape is very fragmented with about 18,000 3PLs and with virtually no company having a national network. The market is expected to continue growing at about 10% CAGR from 2006 to 2010 to reach about \$720 billion in 2010. With WTO commitments in the logistics industry, significant opportunities exist for foreign providers.

Key market dynamics. There are six key trends in the logistics sector: 1) continued growth in logistics market; 2) increased outsourcing to 3PLs; 3) increasing foreign presence; 4) consolidation and increasing quality of domestic 3PLs; 5) de-regulation and standardization and 6) greater use of technology

Key opportunities and market entry options. Opportunities for US companies exist in several areas such as specialist 3PLs, supply chain management services, warehousing, software, and technology products. Different



Source: China Federation of Logistics and Purchasing

¹ Harbin, Dalian, Qingdao, Tianjin, Xian, Wuhan, Hangzhou, Ningbo, Nanjing, Chongqing, Kunming, Zhuhai, Shenzhen, and Xiamen

² Dollar values are calculated using USD-RMB exchange rate of 7.75

market entry options are possible and include WOFE, JV, Representative office establishment, partnership/cooperation and pure export using distributors or agents with no direct commercial presence.

Key Factors Affecting Industry Development. There are three main factors attributed to the overall low level of development in the logistics industry.

General poor understanding of logistics - logistics is normally defined in terms of the “hardware” aspects (such as the number of warehouses and trucks) while the “software” aspects (management practices, qualified personnel etc.) are often underestimated. Qualified logistics managers in both government and private companies are a scarce resource.

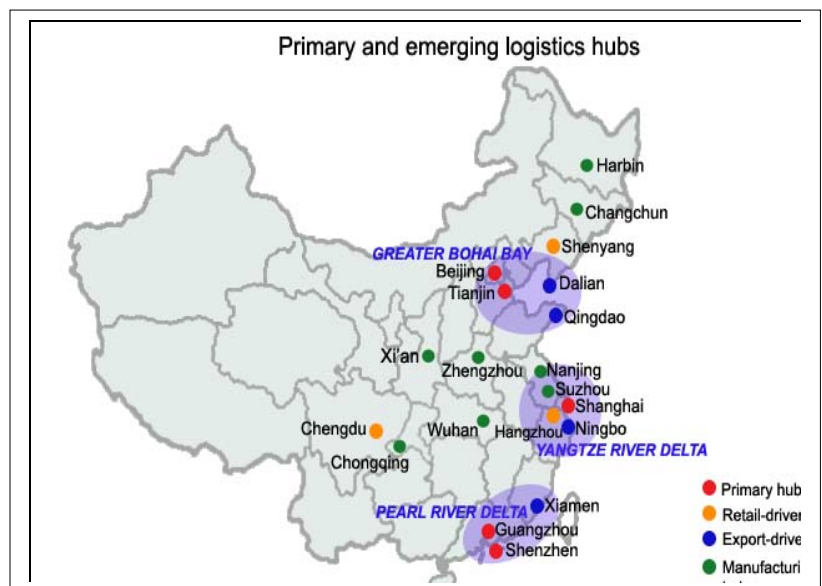
Limited use of technology and IT systems – the limited penetration of technology makes it difficult to manage information and coordinate logistics efficiently. While large manufacturers (especially foreign-invested ones) may be ready to implement IT systems or technology like RFID, most wholesalers, distributors, and 3PLs along the supply chain do not have the resources or capability to do so.

Inadequate regulations and over-regulation – Inadequate regulations paired with over-regulation at different tiers of government (provincial and local), have been an obstacle to consolidation and to 3PLs developing a nation-wide network. The 11th Five Year Plan, however, outlines plans to develop and improve the overall level of service in the industry.

Primary logistics hubs. The majority of China’s logistics facilities are concentrated in the three main economic regions – the Yangtze River Delta, Pearl River Delta and Bohai Bay regions. These three regions account for 85%³ of China’s total logistics facilities and have five primary logistics hubs. The vast majority of logistics and distribution activity in these primary hubs is centered on China’s booming import-export demand for logistics services. However, *as China’s domestic economy continues to expand at a rapid pace, shifting from FDI to consumption based, domestic demand (not import-export based) for logistics services is expected to grow rapidly.* Much of this domestic demand will come from China’s emerging markets outside of the three megacities that are the common focus for most foreign logistics providers.

Emerging hubs. There are 15 emerging hubs that can be classified into three main types:

1. **Retail-driven hubs** are located in **Shenyang, Hangzhou** and **Chengdu**. Logistics demand is driven by strong consumer markets and retailing activities.
2. **Export-driven hubs** are located in port cities along the East coast, e.g. **Dalian, Qingdao, Ningbo** and **Xiamen** and are recording high growth rates. For example, container traffic in **Ningbo** grew 36.4% (compared to growth in Shanghai of 19%) to reach 5.8 million TEUs in 2006.



³ Source: Jones Lang LaSalle

3. **Manufacturing-driven hubs** are located both inland and in the North East. Government policies aimed at developing the Western and Northeast regions (“Go West” and “North East Regeneration” policy) fueled manufacturing activity in cities like *Chongqing*, *Xi’an*, and *Changchun*. Another manufacturing-driven hub is *Suzhou*, which has one of the most successful industrial parks in China hosting more than 1,000 foreign companies.

Promising Markets in Emerging Cities

Hangzhou – “The Finest City in the World”

Located 110 miles south of Shanghai, Hangzhou is the capital of Zhejiang province and one of the Yangtze River Delta’s most economically vibrant cities. Regarded by Marco Polo as “beyond dispute the finest and the noblest city in the world,” Hangzhou is now revered for its popular tourist destinations and pro-business atmosphere. For three consecutive years, Hangzhou was ranked as the #1 City in China for business by Forbes magazine.⁴ Moreover, Hangzhou has the 8th highest per capita GDP in China. Hangzhou and Shanghai are currently in negotiations over a USD \$4 Billion project that will link the two cities with the world’s first inter-city Maglev train line. The new line is scheduled to be completed by 2010 and should cut travel time between the two cities to under half an hour.

Hangzhou Economic Indicators

City Population: **6.52 Million**
Provincial GDP: **USD 140.54 Billion**
Annual Avg. Per Capita GDP: **USD 4,620**
Import Value: **USD 18.5 Billion**
Imports from US: **USD 840.4 Million**

Logistics and Distribution

Hangzhou is quickly emerging as one of China’s retail logistics hubs due in part to the City’s strong information infrastructure, availability of relatively cheap land and abundant physical infrastructure. Many of the cities commercial enterprises, particularly in the retail, chemical and pharmaceutical sectors are currently in the process of procuring logistics expertise in the areas of e-commerce, distribution and logistics centers as well as technologies such as RFID.

Qingdao— Jewel of Shandong

Located on the southern tip of the Shandong Peninsula, Qingdao is one of Eastern China’s major economic centers. Nestled between mountains and ocean, Qingdao’s unique cityscape is studded with lovely beaches, classic European architecture and ample green landscape. The city is well known for its historic and scenic tourist attractions, as well as being one of the best places in China to live and do business.

Qingdao Economic Indicators

City Population: **7.3 Million**
Provincial GDP: **USD 36 Billion**
Annual Avg. Per Capita GDP: **USD 3,812**
Import Value: **USD 44.95 Billion**
Imports from US: **USD 4.37 Billion**

The World Bank has honored Qingdao as one of China’s six “Golden Cities” (a measure of investment climate, harmoniousness, governance and other measures).⁵ In recent years, Qingdao has attracted billions in foreign direct investment and engages in trade with virtually every country on the planet. Among the city’s 17,854 foreign investment projects, 76 Fortune 500 companies have established projects in Qingdao.

Logistics and Distribution

Shandong Province is one of China’s leading manufacturers of pharmaceuticals and chemical/petrochemical products and Qingdao is emerging as the regional hub for these sectors. As

⁴ http://www.forbes.com/business/2004/09/03/cz_rf_0903chinabest.html

⁵ See: World Bank Report— “Governance, Investment Climate and Harmonious Society: Competitiveness Enhancements for 120 Cities in China”; released October 8th 2006.

such, demand for foreign expertise and technology in these distribution sectors is expected to have strong sustained growth.

Chongqing— The Gateway to Western China

Located on the edge of the Yungui Plateau, Chongqing lies at the intersection of the Jialing and Yangtze rivers. Chongqing has historically been a major inland port and an important channel for delivering goods from southwestern provinces to China's eastern coastal areas. One of only four municipalities that are directly administered by the central government, Chongqing is southwestern China's largest ground, water, and air transportation hub. The city serves as a major industrial center and is well endowed with a host of natural resources. As one of the chief beneficiaries of the central government's Western Development strategy, Chongqing is being groomed to help facilitate the development of inland China.

Chongqing Economic Indicators

Urban Population: 4.1 Million
Municipal Population: 32 Million
Provincial GDP: USD 38.75 Billion
Annual Avg. Per Capita GDP: USD 4,569
Import Value: USD 44.95 Billion
Imports from US: USD 4.37 Billion

Logistics and Distribution

Chongqing is currently being promoted as the key logistics hub for the Chinese government's "go west" strategy and is expected to become the distribution platform for much of China's vast interior.

Nanjing— Southern Capital and Regional Hub

Located in the Yangtze River basin, Nanjing is the political, economic and cultural center of Jiangsu Province. Considered one of China's four great ancient capitals, modern Nanjing has emerged as eastern China's second largest commercial center. The city ranks seventh in overall competitiveness among Chinese cities and was recently ranked by Forbes magazine as being one of the top ten commercial cities in China. Nanjing's growing industrial sector has benefited from the city's abundance of natural resources and close proximity to Shanghai.

Nanjing Economic Indicators

City Population: 6 Million
Provincial GDP: USD 191 Billion
Annual Avg. Per Capita GDP: USD 6,449
Import Value: USD 100.4 Billion
Imports from US: USD 6.1 Billion

Firms from the United States have historically fared well in Nanjing. Over a thousand American companies have operations in the city. In 2005, the U.S. ranked as Nanjing's second largest trading partner.

Logistics and Distribution

Nanjing is one of China's primary highway, waterway and railway hubs. In addition to having its major manufacturing logistics hub, Nanjing is expected to rise in importance to the chemical/petrochemical and pharmaceutical logistics sectors.

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