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**REDFERN ASSOCIATES**

THE CHINA WINE MARKET

SECTOR OVERVIEW 2010

*New Zealand*  
**TRADE & ENTERPRISE** 

Produced by *Redfern Associates*

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## THE CHINA WINE MARKET OVERVIEW

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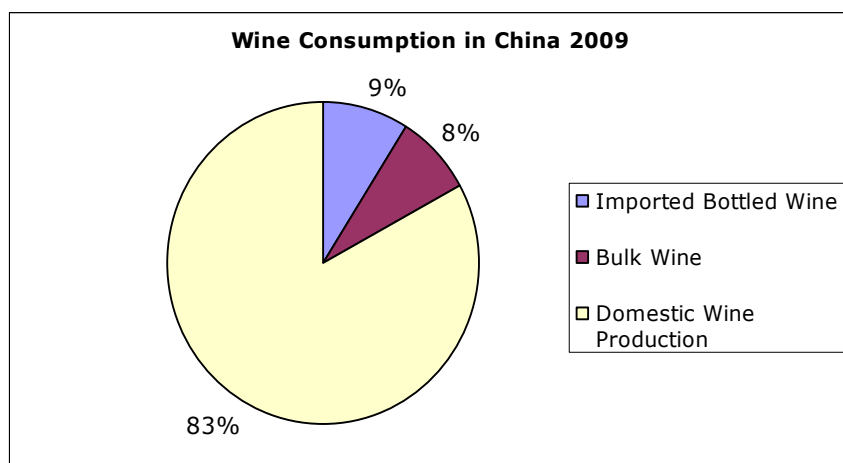
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## 1. MARKET OVERVIEW

China has been making various forms of wine for some 2,000 years, although not in a style resembling western wines until the 20<sup>th</sup> century. China claims over 160,000 acres of vineyards nationwide, but many are located in remote areas, such as Xinjiang, where Silk Road traders brought seeds centuries ago.

Despite this history, the wine industry in China has only recently begun to develop into a significant market. Twenty years ago Chinese consumers tended to drink beer and grain spirits, but in 1987 the Chinese Government began to reduce alcohol related illnesses and encouraged consumers to drink less grain-based spirits, and more beer and grape wine.

Wines have gradually attained consumer acceptance, not least due to Chinese Premier Li Peng, who in 1996 decreed that state banquets should be enjoyed with wine instead of spirits. The influence of western eating and drinking habits has been key in this development, as have rising average incomes in China. Indeed, wine is now becoming a fashionable drink for the wealthy younger generations of urban Chinese, and the favoured drink of China's elite.



The value of the market has almost tripled since 2003 to 1,046 million litres, and Chinese consumers' tastes have become increasingly sophisticated. Not only is there more foreign wine available in restaurants and stores, but the number, variety and quality of domestic wines has also increased, providing local consumers with a greater range of products.

Source: National Bureau of Statistics of China.

The quality and brand strength of some domestic wines is reaching such a level that it can compete on price with imported wines, and an export market looks to be developing. With approximately 600 million young Chinese exploring new types of alcoholic drinks, the potential market for wine sales in the future looks promising.

### 1.1. CHINA WINE MARKET SIZE AND PER CAPITA CONSUMPTION

Wine is heavily taxed, subject to import duties, value-add and consumption tax. Total taxes account for somewhere in the region of 50% of the final retail price. This creates a strong incentive for wine traders to understate sales for tax purposes, and overstate sales for marketing purposes. This adds to the confusion caused by imprecise definitions used when gathering market statistics. Furthermore the lines between the retail, wholesale and catering trades are often blurred.

Total and Per Capita Wine Consumption by Year							
	2003	2004	2005	2006	2007	2008	2009
<b>Wine Consumption (ml)</b>	346	373	442	512	699	751	1,046
<b>Per Capita Wine Consumption (litre)</b>	0.26	0.28	0.34	0.39	0.53	0.57	0.80

Source: WTA

China's annual per capita wine consumption is still low compared with traditional wine drinking nations such as France (56 litres), Australia (25 litres) and the UK (19 litres). But the market potential for wine is huge, particularly given China's population and its increasing demand for wine which is best illustrated by the industry's double digit growth in recent years. Wine still accounts for considerably less than 5% of total alcohol retail consumption in China, but is expected to grow by 15% per annum over the next five years, according to a Chinese government study.

## 1.2. MARKET SEGMENTATION AND MAJOR PLAYERS

Currently, there are over 500 wineries in China. Industry data shows that the top three wine brands - Changyu, Great Wall and Dynasty - control as much as 50%-60% of the market. Most sources generally consider Changyu as the top wine brand in China, followed by Great Wall and then Dynasty. These companies have well-developed national sales networks covering both retail and Horeca channels. Other wine brands dominate local markets, like Harvest Wine in Beijing, Weilong Wine and Huadong in Shandong, and Yunnan Red in South China.

Due to the shift in Chinese consumer preferences from spirit products to wine, China's powerful *baijiu* grain spirit companies have now stepped into the wine business in the hope of capitalising on the growth of the wine market. Maotai and Wuliangye, the most recognized of these companies, have recently established wine businesses, leveraging their *baijiu* sales networks.

China's wine consumption is concentrated in the economic centres, such as the Yangtze River Delta and Shanghai, its prosperous satellite cities in Jiangsu province to the west and Zhejiang province to the south. In North China, Beijing and its surrounding cities and coastal cities like Dalian are growing markets, as are South China's two large economic centres of Guangzhou and Shenzhen with their geographic connections to Hong Kong.

The high-end wine market is dominated by imported wine brands in the tier 1 cities of Beijing, Shanghai, Guangzhou and Shenzhen. Imported wine is sold through exclusive distributors who have competitive advantages and established sales networks with hotel, restaurant and cafe (Horeca) channels.

## 1.3. CONSUMER PROFILES

Wine drinking in China is associated with western customs, and is viewed as fashionable, sophisticated and worldly. The targeted demographic for typical customers include mid to high income earners, those in tertiary education and the 20-50 year-old age group. Female consumers are also been observed to drink more in recent years.

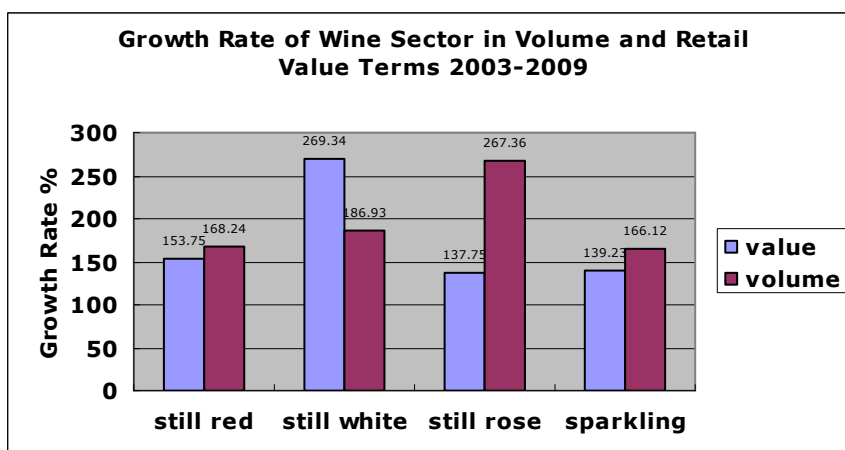
At present, wine purchases by average Chinese consumers fall largely into two categories: Banquet dining and retail gift purchases. In neither case does the buyer buy wine for themselves. Instead wine serves as an elegant and tasteful gift to share or for others to enjoy.

Banquets generally involve competitive drinking among men. In a formal banquet drinking environment, ordering expensive dishes and drink demonstrates respect for guests, and red wine is increasingly substituted for *baijiu* at toasts. Wine, especially red, is perceived as a good gift during holidays like Spring Festival when family and friends gather to celebrate and where gifts packaged in elaborate cardboard boxes are popular.

Wine will only begin to become a mass market product when drunk by rural inhabitants and urban professionals alike, and this is a very long way off. It has been estimated that, at present, if you discount the large number of rural workers and lower paid industrial workers who might never buy a bottle of wine in their lives, the maximum number of people worth considering as a marketable demographic in China is at the very most 167 million. If this population segment is used then the average per capita consumption (including retail and HoReCa) would be about 5.54 litres per capita or 7.4 bottles (750ml) during 2009.

Industry experts suggest that 80% of wine sales are red wine, though this varies across China. For example Shandong province, a coastal province on the same latitude as Bordeaux and well-known for wine production, is home to a more sophisticated consumer who is much more accustomed to drinking white wine.

Red wine is drunk by Chinese consumers almost exclusively as a table wine accompanying a meal. Future industry growth will rely heavily on the development of the 'meal occasion' market and Chinese consumers' taste for new foreign products. Expensive bottles of red wine have become a trophy drink of the Chinese new rich to demonstrate wealth and good taste.



Growth rates from 2003 to 2009 show a marked increase in white wine consumption and variety in the market. Source: Access Asia

Growth in white wine sales is mainly due to the preferences of Chinese women, who tend to consume it mixed with soft drinks. Consumption of Rosé wine remains very small, although volumes have more than doubled in

recent years. Sparkling wine sales have also increased amongst wealthy Chinese, who make purchases to celebrate special occasions, especially weddings.

#### 1.4. IMPORTED WINE

##### BULK

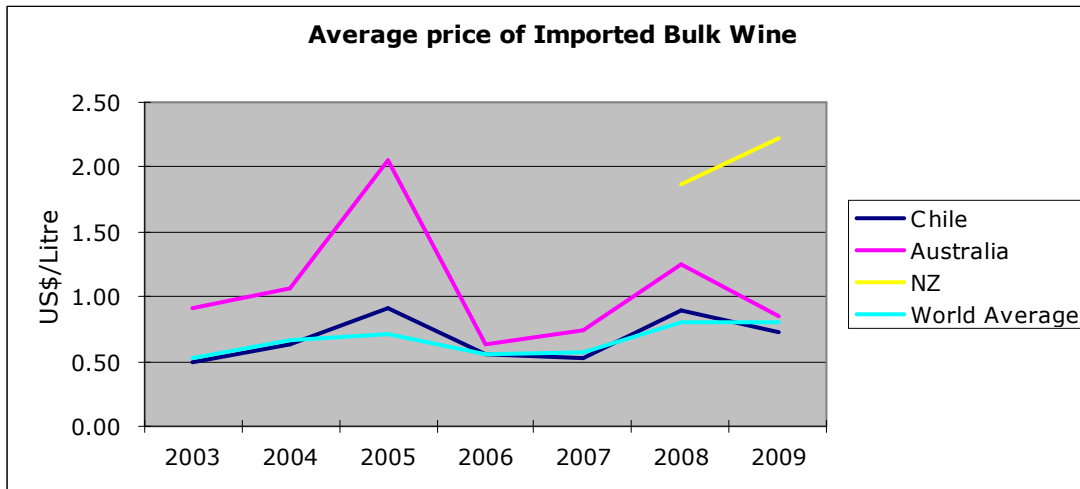
Bulk wine import volume has increased 119% from 2003 to 2009 due to increased consumption and the relatively slow growth of domestic grape production. Bulk imports are driven by low-end shipments from countries like Chile, Argentina and Australia.

In 2009, whereas China imported bulk wine from 26 countries, Chile alone accounted for approximately 53% of the total volume. Chile and Australia together accounted for 77%. Chile has surpassed France and Australia to become the number one bulk wine supplier.

Bulk wine imports contribute significantly to China's overall wine production. For example, 751 million litres of wine was consumed in 2008 and 105 million litres was imported bulk from abroad that same year. It is difficult to determine the end-destination of bulk wines - how much is blended and how much is bottled unadulterated.

According to China Customs the volume of bulk wine imports to China in 2009 were down 24%, yet Australian bulk wine volume increased 532% during the same period. Australia dumped 19 million litres on the Chinese market in 2009 which have damaged pricing strategies and brand building efforts of the past five years. Whereas Argentina's imports of bulk decreased from 25 million litres to only 2 million, Chilean imports dropped by 10% and though it remains the top bulk importer is now entrenched in a low-price game both in bulk and bottled segments.

New Zealand's bulk wine imports are small and at a high price per liter. Due to its price, New Zealand wine, bulk or bottled, falls in the premium wine category. Indeed, New Zealand bulk wine is 3-5 times more expensive than other bulk wines, and has therefore not been widely sought by Chinese wine companies, which operate on price in the low- to medium-end market.



New Zealand imported bulk wine to China increased 100% in 2009 off a small volume, of 48,000 litres (2 containers) to 96,000 litres (4 containers) at an average price of US\$2.22 per liter. Australia's average bulk wine price is (CIF) US\$0.85 per liter.

#### BOTTLED

Bottled wine volumes have increased almost 20 fold since 2003, and despite the financial crisis, grew a further 58% in the last year. The value of trade however, only increased 36%, with the result that more lower- to middle-end priced wine entered the China market.



According to the World Trade Atlas, the average price of imported bottled wine (CIF) has decreased from US\$4.80 per litre in 2008 to US\$4.14 in 2009. The volume of New Zealand wine imports has however increased 84% and stands at an average price per litre of US\$6.05. While volumes are still low, growing from 50 to 100 containers in the last 12 months, this represents a breakthrough, and is due to the sustained efforts of those few committed to the market.

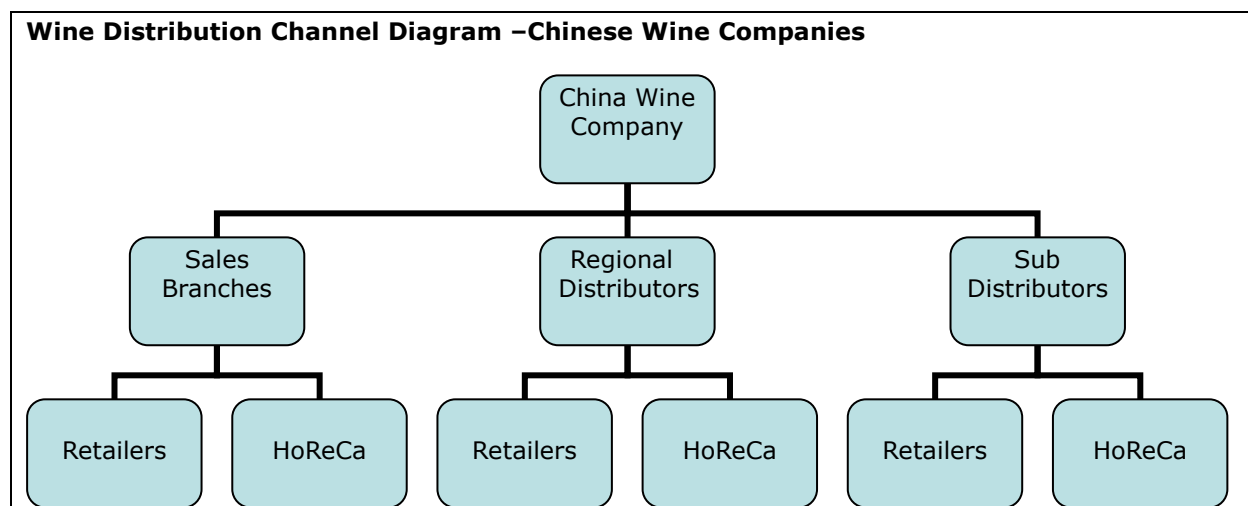
The growing maturity of the wine retail market is reflected by consumers trading up to more expensive wines. Bottles priced between US\$5-US\$10 now account for 23% of wine sales, a significant increase from just 3% in 2003, and a trend which is likely to continue.

On restaurant wine lists, New Zealand wines are generally priced at between US\$40-US\$90 per bottle in Shanghai and Beijing.

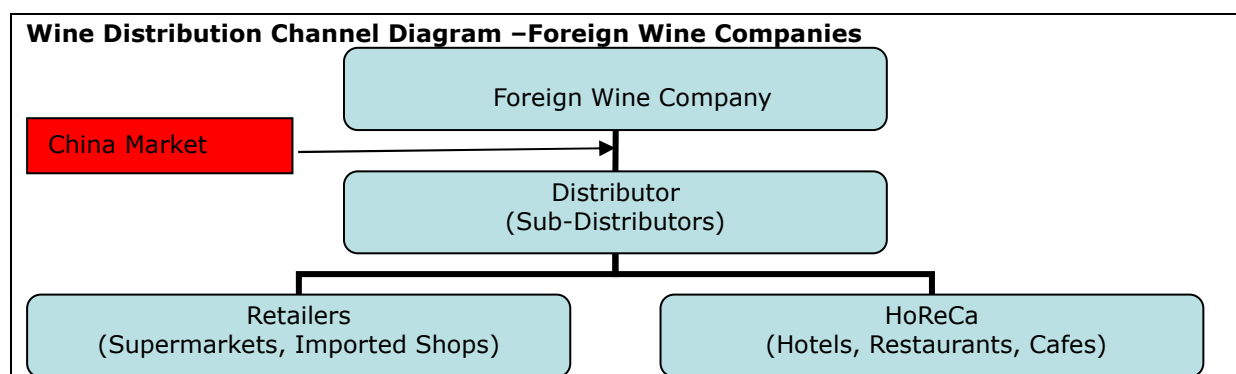
### 1.5. DISTRIBUTION CHANNELS

In China, wholesalers, retailers, restaurants, caterers, and distributors all sell wine to individuals and businesses in both small and large quantities. A clear distinction between what is retail and what is not seems not to exist, which makes it difficult to analyse the total market size.

Traditionally, there are two sales channels for wine – retail and HoReCa (hotels, restaurants & cafes). Anecdotal evidence suggests that 70%- 80% of wine sales occur in the Horeca channel. However these figures differ greatly from the 50:50 ratios that industry bodies state.. This again demonstrates the problems of data accuracy covering the retail sector.



The leading wine distributors of imported premium wine are still foreign companies, many of which have been in the wine business in China for a decade or more. These companies traditionally started serving premium foreign hotels and have grown into the Horeca channels and many now have retail affiliations and are aggressively pursuing the gift market.



The established distribution companies are frequently approached by overseas suppliers, including companies from New Zealand, but are reluctant to take on additional labels unless they are a “sure bet” and are supported by significant marketing and financial support. This reflects the relative immaturity of the market and the fact that imported wine, especially at the premium end, is still out of the reach or unknown to most consumers. Leading distributors carry between one and four New Zealand labels.

## 2. MARKET CHANNELS

### 2.1. SUPERMARKETS

New Zealand wine is poorly represented in China supermarkets, as detailed below by the total label count conducted in the Shanghai supermarkets displayed below..

	Chile	France	Australia	New Zealand
City Shop	86	74	120	2
Metro	112	98	156	2
Lian Hua	0	0	3	0
<b>Totals</b>	<b>198</b>	<b>172</b>	<b>179</b>	<b>4</b>

There is no doubt that the hypermarket game in China is difficult to penetrate and all about scale. Prohibitive listing fees, profit rebates, pricing and volume requirements preclude many smaller players from entering this sector. Even so, retailers catering to an increasingly discerning consumer and recognising the 'next best thing' are increasingly interested in New Zealand wines to compliment their range.

Major foreign-owned supermarkets devote a significant amount of retail space to wine, and some 80%-90% of this is imported. Generally, less than 30% of the wine featured is white and less than 10% is Chinese branded, though this dynamic is changing fast as powerful Chinese wine companies are upping their marketing efforts. Prices in this channel range from RMB40 to over RMB1,000 per bottle, and many feature a Grand Cru selection to appeal to the high-end market.

### 2.2. RESTAURANTS AND HOTELS

Many high-end Chinese restaurants and domestic hotel chains remain proudly loyal to Chinese brands and feature a growing range of Chinese branded products, which are often expensive. This may have much to do with entrenched relationships and ownership models which give preference to national product. A surprisingly large number report only selling up to 10 bottles a day. Prices range from RMB50 into the thousands, and promotions are common place.

For the most part, only expensive western restaurants carry New Zealand wines: Lists are generally filled with mid- to high-level French, Italian, US and Australian brands. Prices range from RMB200 to Grand Cru level in establishments whose clientele is now well over 50% Chinese. High-end foreign players and powerful Chinese distributors dominate supply via well-developed and often exclusive relationships.

### 2.3. PRIVATE LABELS

The private label market in China is rapidly developing and covers basic food commodities. Foreign players are bringing private labels to the Chinese market and domestic hypermarket powerhouses are fast adopting the practice. The concept of store own-branded goods is becoming accepted by Chinese consumers, paving the way for more elaborate private label goods to develop.

A random survey shows some retailers have already introduced their own private label wine. This keeps costs down and minimal marketing is needed. Retailers' private label wines mainly compete in the mass market category, targeting newcomers to the wine scene, or those on a tight budget who want to indulge in an occasional glass.

### 3. VALUE CHAIN ANALYSIS

Retail mark-ups are comparatively less than in the Horeca sector, where the 'meal occasion' is still a key driver. Grabbing a share of the Horeca channel requires the highest levels of distributor support.

Distributors in China tend to mark-up imported bottled wine as much as 100%-200% and restaurants and hotels typically add 250%-300% to the distributor price. As importers, distributors wholesalers and retailers play multiple roles in the value chain, and many in China do, runaway profits are possible.

Multiple parts of the value chain can be controlled in relatively new product categories, like New Zealand wine, which are not strongly competed over and where volumes are not high to have yet brought discipline. High retail prices for New Zealand wine do reflect higher buying prices but are also due to New Zealand wine still being a little known and low volume product.

China Wine Value Chain							
	Domestic Wine in Supermarket	Imported Wine in Supermarket		Imported Wine in Restaurant		NZ Imported Wine in Restaurant	
USD to RMB 6.8	RMB	USD	RMB	USD	RMB	USD	RMB
<b>Selling Price</b>	¥ 50.00	US\$17.46	¥ 118.75	US\$31.43	¥ 213.75	US\$58.82	¥ 400.00
Margin	20.00%	40.00%		66.67%		71%	
<b>Sub-distributor Wholesale Price</b>	¥ 40.00						
Sub-distributor Margin	25.00%						
<b>Distributor Wholesale price</b>	¥ 30.00	US\$10.48	¥ 71.25	US\$10.48	¥ 71.25	US\$16.78	¥ 114.08
Distributor Margin	33.33%	50.00%		50.00%		50.00%	
<b>Distributor Purchase Price</b>	¥ 20.00	US\$5.24	¥ 35.62	US\$5.24	¥ 35.62	US\$8.39	¥ 57.04
<b>Duty Clearance</b>	¥ 0.00	1.00%		1.00%		1.00%	
<b>Total Import Tax</b>	¥ 0.00	48.20%		48.20%		37.28%	
<b>CIF SH or Ex-Winery for Domestic Wine</b>	¥ 20.00	US\$3.50		US\$3.50		US\$6.05	

#### NOTES

1. Data quoted is per bottle, based on site visits and interviews performed in Shanghai, March 2010.
2. Freight and clearance costs are approximate; storage costs have not been included. Total Import Tax is compounded including tariff VAT and consumption taxes. Tariff rate is that currently under the New Zealand – China FTA rate reduction schedule in 2010.
3. Generally speaking, sub-distributors take a similar margin as distributors. To penetrate outlying local markets, there maybe as many as 5 layers of distributors where margin is distributed equally.

#### 4. CHINA-NZ FREE TRADE AGREEMENT

The New Zealand China Free Trade Agreement came into force on 1 October 2008. As a consequence many New Zealand products including wine have seen a drop in their respective tariff rates. The FTA should result in an increase New Zealand wine exports to China, given the tariff advantages of come 2012 – 14 percent. (These advantages are also shared by Chile, which signed a similar FTA in 2005).

China Wine Import Tariff Rates Under FTA for New Zealand and Chile											
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
<b>Bottled</b>	14.0	14.0	14.0	11.2	8.4	5.6	2.8	0.0	0.0	0.0	0.0
<b>Bulk</b>	20.0	20.0	20.0	16.0	12.0	8.0	4.0	0.0	0.0	0.0	0.0

Source: China Ministry of Commerce

On top of the tariff, imported wine is also subject to consumption tax (10%) and VAT (17%). Total import tax, rather than being the simple sum of these percentages, is calculated using a compound formula. See the Importation section for calculation details.

The following table compares total import taxes on wine imported from New Zealand or Chile, with, other counties who are subject to the normal tariff rate.

China Total Import Tax Rates on Wine							
		2010	2011	2012	2013	2014	2015
<b>Normal</b>	<b>Bulk</b>	56.0%	56.0%	56.0%	56.0%	56.0%	56.0%
	<b>Bottled</b>	48.2%	48.2%	48.2%	48.2%	48.2%	48.2%
<b>NZ FTA</b>	<b>Bulk</b>	40.4%	35.2%	30.0%	30.0%	30.0%	30.0%
	<b>Bottled</b>	37.3%	33.6%	30.0%	30.0%	30.0%	30.0%

Source: Customs Import and Export Tariff of the People's Republic of China

Note that to fully benefit from duty reductions under the NZ-China FTA, a FTA Certificate of Origin is required by Chinese authorities. In the case of wine shipments made solely from grapes grown in New Zealand, the NZ Wine Institute is the certification body designated to provide this document.

If an export consignment does not obtain a preferential tariff because of a failure to present a FTA Certificate of Declaration of Origin, the importer in China can still claim a refund within 12 months of the product being imported.

A common complication for exporters occurs when a consignment is shipped via a third country, rather than directly from New Zealand, in which case FTA declarations maybe not be recognised. Consequently exporters should pay close attention to how shipments are transported in order to ensure proper documentation and compliance in order to reap the benefits of favourable FTA tariffs.

## 5. IMPORTATION PROCESS

Importation of wine is a relatively straight forward procedure, though compliance and full declaration of import values is demanded. The process normally begins upon arrival with the General Administration of Quality Supervision and Inspection and Quarantine of the PRC (AQSIQ) also known as CIQ, then moves on to the Tariff office, and then Customs for clearance.

Many designated import agents will oversee this process for a fee. While they may possess the required licenses, distributors still often choose to employ specialists for the job.

When product arrives at port, with the details of the order the consignee can select whether to transfer the product into a bonded warehouse or release from bond at which point the importer pays tariff, VAT and Consumption taxes. Given the high ITR, clearing product immediately can place significant costs onto the distributor prior to the product being ready for sale.

Once the product is cleared, wine is shipped to the distributors own warehouse or to that of an outsourced logistics partners.

### REQUIRED IMPORT DOCUMENTATION INCLUDES:

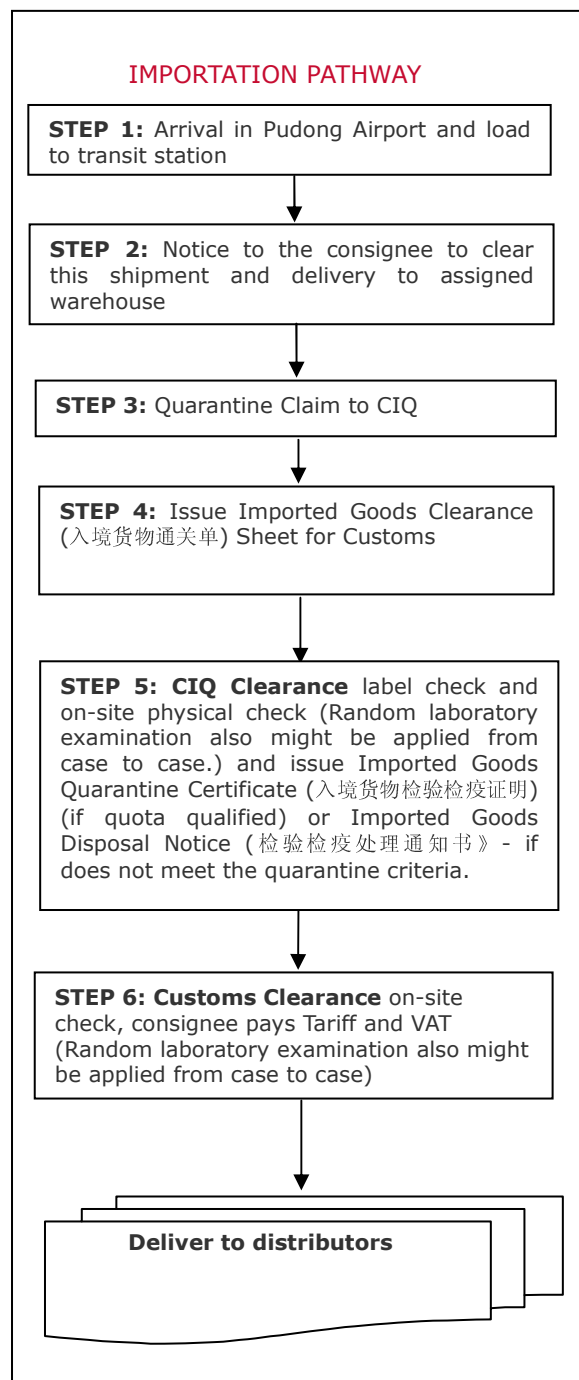
1. Digital Image of the Labels
2. Certificate of Origin (original)
3. Original Bill of Landing
4. Invoice
5. Wine Analysis Certificate
6. Certificate of Quality/Health/Free Sale\*
7. Packing List
8. Bottling date
9. Wood Palate IPPC stamp (certificate of fumigation if no IPPC mark)

### IMPORT TAX CALCULATION

The following table details total import taxes (ITR) for bulk and bottled wine:

- Bulk Wine 20%
- Bottled Wine 14%
- Consumption tax rate (CTR) 10%
- VAT rate 17%

$$\text{Import tax rate: } \frac{\text{ITR} + \text{CTR} + \text{VAT} + \text{ITR} * \text{VAT}}{1 - \text{CTR}}$$



\*Application forms can be obtained at: [www.nzfsa.govt.nz/processed-food-retail-sale/free-sale-certificates/forms.htm](http://www.nzfsa.govt.nz/processed-food-retail-sale/free-sale-certificates/forms.htm)

## 6. REGULATORY, LABELING AND LICENSING RESTRICTIONS

The Chinese government have recently enforced regulations supervising standards and labelling for foods. It is critical for New Zealand exporters to understand the relevant rules if they are looking at a long-term position in China. There are numerous laws and regulations relating to imported food and beverage products in China, which are updated or revised continuously. Moreover, there are documentation requirements for New Zealand exporters to enjoy FTA tariff advantages.

The information provided here is for reference only: When negotiating supply contracts, and before beginning to export, companies are advised to consult closely with their importer or distributor.

### CERTIFICATES OF ORIGIN

To benefit from the Free Trade Agreement, you need to:

- Determine whether your goods qualify for access under the agreement
- Obtain a certificate of origin to verify your goods are legitimately made in New Zealand.

The New Zealand and China Customs administrations have signed an exchange of letters that rectifies a number of issues with the certificate of origin format under the Free Trade Agreement (FTA). These changes, which came into effect on 1 July 2009, should assist the entry of New Zealand goods into China.

### CERTIFICATES OF NON-MANIPULATION

In January 2010, the New Zealand Customs Service met with a delegation from China Customs to discuss implementation of the New Zealand-China Free-Trade Agreement (FTA). China Customs shared their transshipment guidelines with New Zealand. The key points are:

- Goods that transit through third countries should not undergo any other operation in that country other than treatment necessary to keep them in good condition
- If the goods are being stored in transit in a third country, they should stay under the administration and supervision of Customs and not be stored for longer than six months
- If the goods transit a third country, China Customs may request other relevant documents to confirm that the goods still meet the rules of origin. These documents include:
  - A valid certificate of origin (or declaration if allowed for under the FTA).
  - Other commercial documents, such as the commercial invoice or shipping documents or bill of lading.
  - If the goods transit through either Hong Kong or Macau, the importer will need to supply to China Customs documents issued by China Inspection Company Limited (Hong Kong) or CCIC Macau Company Limited

If these relevant documents are not provided, China Customs may conduct an inspection. Exporters, who are unable to provide relevant documents should ensure that the seal of the container is intact, and seal and container numbers match the information on the bill of lading.

- China Inspection Company Limited (CIC) (Hong Kong) can issue Certificates of Non-Manipulation for goods transhipped through Hong Kong to China. Please refer to <http://www.cichk.com.hk/index-e.htm>
- China Inspection Company Limited (CIC) (Macau) can issue Certificates of Non-Manipulation for goods transhipped through Macau to China. Please refer to the website [http://www.macau-ccic.com/E\\_about.htm](http://www.macau-ccic.com/E_about.htm)
- Singapore Customs can issue Certificates of Non-Manipulation for goods transhipped through Singapore to China. Please refer to the website <http://www.customs.gov.sg/leftnav/trad/certificates+of+origin.htm>

## LABELLING REGULATIONS

Prior to the product being imported or distributed, labeling verification must be sought from China Inspection and Quarantine (China CIQ), a process which takes 1-2 weeks. When going through this procedure, exporters should carefully consider the value of specifying that they will retain ownership of the label after CIQ approval in the contract they have with their importer or distributor. This will make it easier to work with other distributors in the future should the need arise.

A summary of the main items required for verification of labeling is as follows:

- Application Form of Import Food Labeling Verification; (<http://www.cichk.com/pdf/spsqs.pdf>)
- Brief explanation of the original English label in Chinese
- "Certificate of Origin" or "Wine Export Certificate"
- Registration information and qualification of distributors or dealers
- Samples of Chinese label (see content below)
- Sample wine for inspection (2 bottles of each label).

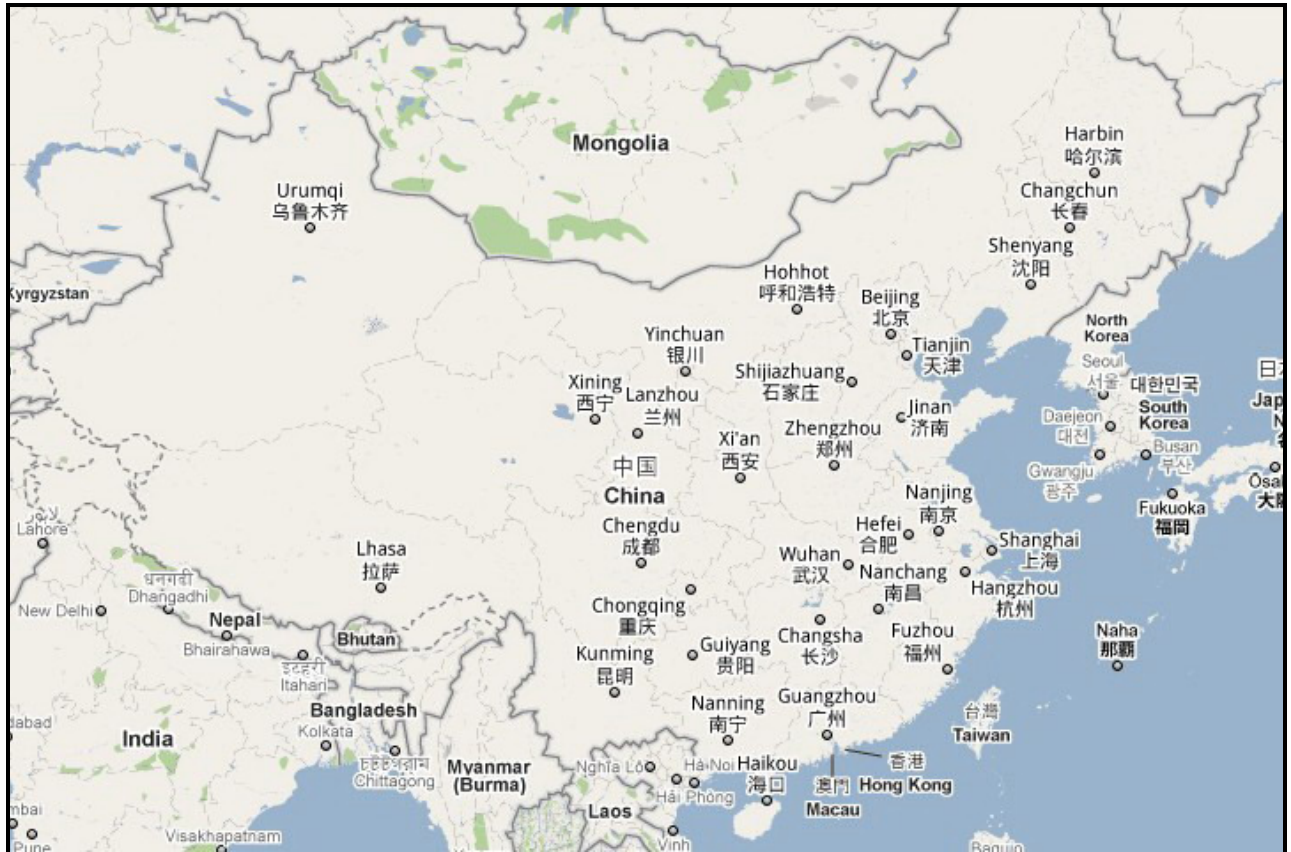
The National Standard for the Labelling of Foods (GB7718-1994) specifies the following mandatory items for still or sparkling wine labels:

1. Name/Brand of the Wine
2. Ingredients
3. Net Content (ml)
4. Alcoholic Content (%) (V/V)
5. Production Date (yy/mm/dd)
6. Packer/Distributor (Name and Address)
7. Content of Must (%) (Sake is exempt from this requirement)
8. Country of Origin
9. Quality Guarantee and/or Storage Period (yy/mm/dd)
10. Content of Sugar (gram/l)
11. Content of Sulfur Dioxide (SO<sub>2</sub>) (It has been re-enforced by AQSIQ since late 2007)

Although the law bans the use of temporary adhesive labels, some foreign wineries continue to attach small and simple labels (translated into Chinese) on the outside of the bottle. This is done either prior to delivery to China or by the Chinese importer under the supervision of a Chinese inspection and quarantine organization. This is a risky option and as such New Zealand Trade and Enterprise recommend that exporters strictly abide by the formal labeling regulations when developing business in China.

On arrival, individual shipments are inspected and issued a hygiene certificate if they pass. Products that fail inspection cannot be imported.

APPENDIX – CHINA MAP



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