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Chinese Authority Strengthens Food Safety in Face of Chinese New Year

The Ministry of Agriculture, National Health and Family Planning Committee, CFDA are other national government departments jointly issued notice that they would strengthen regulation on food safety during China's New Year as known as "Spring Festival".

The bureau chief of agricultural product safety department with Ministry of Agriculture said in the notice that the Ministry would focus on vegetable and animal products, checking vegetable planting base, livestock farm, slaughtering house and agricultural product storage. The key issue is the prevention of illegal pesticide, overuse of antibiotic and illegal additives.

The major market area will be connected with local regulator and regular check will be put to whole-sale market, expo and marketplace for festival gifts.

Su Zhi, chief of food safety standard and monitor department of National Health and Family Planning Committee, said that all levels of health institution are mapping out contingency plans and preparing related equipment. Related staffs will be on call for disease report and management.

CFDA released regulation on infant formula lately that requires

China Updates is a service provided by U.S.-China Health Products Association. The Newsletters are issued approximately three times a month. China Updates provides news on regulatory environment, new legislation, association activities and any information related to China's natural health products industry.

related companies to set up accountability system to strengthen safety management. The regulator also asks the companies to make sure the procurement, production and sales of infant formula to be traceable. (Source: People's Daily)

CFDA Addresses Illegal Addictive in Health Food

Ma Chunliang, chief of food safety regulation department of CFDA, said that the Administration is to crack down on illegal production, sales, additives and promotion of health food companies.

The national campaign that is to address these issues covers about 500,000 companies nationwide and 797 of them were ordered to suspend from daily production. 47 of these companies got their licenses suspended, according to Mr. Ma.

The Administration is to strengthen the crack-down on illegal addictive in health food. So far the police department has received over 468 cases of illegal production, with Administration of Industry & Commerce processing 3,907 cases that involve illegal promotion. (Source: CFDA)

Why Are Cosmetics Players Exiting China?

Recently, mass-market cosmetics manufacturer, Revlon, announced its plans to exit the Chinese market. Revlon derives approximately 2% of its revenues from China. Revlon's direct-selling competitor, Avon Products, is facing similar weakness in sales in the Chinese mainland region.

In recent times, many international retailers have considered closing shop in China to reduce costs and improve operational efficiencies. The latest announcement comes from cosmetics giant L'Oréal, which highlighted plans to end Garnier product sales within the Chinese market, citing a slowdown in the Chinese economy.

In this note, we analyse the current market conditions and trends shaping business performance for cosmetics companies in China. We have price estimates of \$24 for Revlon and \$33 for L'Oréal, against their current market prices of \$25 and \$34 respectively.

Retail sales for cosmetics in China for the year 2012 were estimated to be close to \$22 billion (RMB 134 billion), impacted by a slowdown in the country's economy and lower discretionary spending. In comparison, cosmetics' sales in 2010 stood at approximately \$24 billion, with skin care product sales accounting for more than 60% of total retail cosmetics sales.

This represents an 8.3% erosion in value over a span of two years. Combined with the fact that Chinese retail cosmetics sales witnessed explosive growth and tripled in value during the 2000-2010 period, the retail cosmetics market in China could begin to see a steady decline in product sales in the coming years. Reasons supporting this view on the market include:

Chinese consumers have shown great adoption to online shopping and e-commerce over the past two years. Chinese e-commerce sales topped RMB 1.3 trillion (\$214 billion) and are expected to surpass U.S. e-commerce sales in 2013.

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According to consulting firm Bain & Company, the Chinese e-commerce market is on a 32% growth trajectory, with total sales doubling to reach RMB 3.3 trillion (\$545 billion) by 2015.

Digital penetration, which represents online sales as percentage of total sales, has reached 9% in Tier 1/Tier 2 cities in China and stands at 6% across all cities in China. For cosmetics product sales specifically, this penetration rate is 3-4 times higher in the Chinese market [5], indicating the shift in the customer buying pattern from traditional brick-and-mortar retail outlets to the seller's online platform.

These trends highlight the shift in the consumer purchasing proposition model, with more customers preferring online shopping. Going forward, we expect an increasing decline in comparable store sales growth from brick-and-mortar outlets of cosmetics companies as digital penetration continues to expand in China.

Prestige beauty product sales within the Chinese market have been increasing in recent times, with global players such as Lancôme, Kiehl's (operated by L'Oréal) and Estée Lauder quickly gaining market share. In the skin care segment, L'Oréal has a market share of 17% and is the largest player in China.

L'Oréal has the highest market share in color cosmetics in China, supported by a wide product portfolio of mass-market, mid-range and premium make-up products targeting various customer groups. Maybelline from L'Oréal targets customers in the mass-market color cosmetics market, while L'Oréal Paris and Lancôme target customers preferring mid-range and premium color cosmetics' products. This diverse set of products has helped the company gain market share quickly in China.

Other prestige cosmetics players like Estée Lauder and Japan-based Shiseido also have seen strong offtake of their products, stipulating an increase in luxury product sales in China. Going forward, we expect luxury product sales to continue increasing rapidly as discretionary income continues to expand in China. The infographic shown below indicates how cosmetics product sales are expected to trend in the future.

The exit of Garnier from China indicates L'Oréal's weak footing in the Chinese hair care market. According to Euromonitor, P&G holds the top spot in the Chinese hair care market with revenue

between \$3.5-\$4 billion, and a 37% market share in the country. Rejoice from P&G leads the Chinese hair care market, closely followed by Head & Shoulders and Pantene.

Going forward, we believe the ongoing shift of purchasing cosmetics online will intensify as digital penetration within mainland China increases. Furthermore, we expect existing mass-market cosmetics retailers such as Avon Products to continue facing downward pressure on sales with greater offtake of prestige and masstige products. (Source: trefis.com)

Nu Skin Faces New Pressure in China

A second Chinese agency said it would probe critical reports by the Communist Party's main propaganda organ against Nu Skin Enterprises Inc., illustrating the difficult environment that direct marketers face in an increasingly important market.

China's Commerce Ministry said it was aware of reports by the People's Daily newspaper and that it was "verifying whether the situation is correct." The statement followed one from China's State Administration for Industry and Commerce that it was looking into the U.S.-based company, which sells lotions, anti-aging creams and nutritional supplements.



The People's Daily continued its attack on Nu Skin for a third day on Friday, criticizing the U.S. company's global operations and reiterating the newspaper's view that the company is operating an illegal pyramid scheme in China. "In the development of Nu Skin, there have always been problems of illegal operation and practice," Friday's article said.

Nu Skin didn't respond to requests for comment on the latest article. On Thursday, the Provo, Utah, company said it would "communicate

openly with regulators to address any questions they may have." Nu Skin said "there will likely be a negative impact on China revenue," though it said it was too early to tell whether that would affect its previous earnings forecast.

Nu Skin had sales of \$667.4 million in mainland China in the first nine months of last year, accounting for nearly a third of the company's total. The company had forecast a 22% to 25% increase in revenue for this year and an increase of 25% to 30% in earnings per share.

Like other foreign companies in China, Nu Skin sells its personal-care products through distributors. But Chinese officials have long been skeptical of multilevel marketing, in which distributors earn money from other distributors they bring into the business as well as from what they sell themselves. Chinese media sometimes carry stories that treat such sales organizations as brainwashing cults, a characterization the People's Daily applied to Nu Skin.

Chinese officials in 2005 eased prohibitions on much of what direct marketers do. Since then, direct-market companies have poured into the country. The World Federal of Direct Selling Associations, citing data from its members, said sales rose more than 13% in 2012 to \$19.96 billion, making China the industry's third-largest direct-sales market, behind the U.S., at No. 1, and Japan.

But the new rules restricted multilevel marketing. They also capped the amount a company can pay its sales force at 30% of total country sales and said companies have to set up storefronts as well.

Policing such networks of salespeople can be difficult. "The line can be blurry," said Jin Ling, Beijing-based

director for government relations at consulting and public-relations firm Apco Worldwide.

Sales-force management in China is complicated by get-rich-quick attitudes and by the pervasiveness of social media, which allow distributors to form ad hoc networks of friends and relatives through microblogging services such as Weibo or the WeChat mobile-chat app. "Through WeChat and Weibo, you can leverage existing relationships, family and friends," Ms. Jin said.

Nu Skin sales representatives in China on Friday defended the company. "It is the product that really matters, not the report," said a sales representative who identified himself only as Mr. Zhang. The 38-year-old former mechanic declined to disclose his income, citing company advice.

Another distributor, a woman with the surname Yu, said Nu Skin officials come to distributors' regular gatherings and urge them to follow the law. "The company has fired a number of distributors who illegally operated their businesses and ended the contracts with them," she said. She was critical of the People's



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Daily. "How can the reporter talk to one of the staff randomly and say he got to know the whole company?" she said.

The People's Daily represents the views of some Communist Party members and doesn't necessarily reflect the stance of the government. Still, it can be influential in China. Apple Inc. last year said it would revamp its customer service practices in China following criticism from the newspaper and from China Central Television, the country's official broadcaster.

Nu Skin's shares fell \$5.33, or 6.3%, to close at \$79.47 Friday on the New York Stock Exchange, putting the stock down 42% for the week. (Source: WSJ)

U.S. FDA China List of U.S. Dairy Producers

China's dairy industry has been a nightmare of food safety woes for all involved most importantly consumers. As a result, China's regulators have continued to push the food safety bar up making it difficult for companies to keep pace especially foreign companies.

In response, the U.S. FDA is offering assistance to U.S. firms that wish to export dairy products to China. FDA is taking this action in response to China's State General Administration of the People's Republic of China for Quality Supervision and Inspection and Quarantine (AQSIQ) issuance of Administrative Measures for Registration of Overseas Manufacturers, known as AQSIQ Decree 145. AQSIQ Decree 145, among other requirements, mandates that foreign competent authorities including FDA provide the Certification and Accreditation Administration of China (CNCA) with a "name list of overseas manufacturers of imported food applying for registration" with CNCA for commodities that CNCA has deemed to require registration.

FDA is establishing and maintaining a list identifying U.S. firms that have expressed to FDA their interest



in exporting milk products to China, are subject to FDA jurisdiction, and are not the subject of a pending judicial enforcement action (e.g., an injunction or seizure) or a pending administrative action, e.g. warning letter, and that either: 1) have had a FDA inspection within 3 years with a satisfactory result, or 2) are on the IMS list or the USDA list for the products intended to ship. All the details of this program can be found [HERE](#). (Source: US FDA)

GlucosaGreen's Advantage in UK

TSI Group's CEO Joe Zhou confirmed that its non-shellfish-derived GlucosaGreen® Glucosamine products will not be subject to the UK Food Standard Agency's new policy, which regulates importation of animal-derived glucosamine and chitosan products.

The policy, set to take effect early this year, reflects the UK Food Standard Agency's efforts to harmonize importation procedures for animal-derived food supplement raw materials. This new approach has the potential to significantly impact the importation—and, thus, the supply—of animal-derived glucosamine in the UK as well as throughout the European Union.

"It's clear that these new regulations will disrupt the supply of animal-derived glucosamine ingredients into Europe," said Mr. Zhou. "Our ability to deliver high-quality and non-shellfish derived glucosamine products provides TSI with a unique global leadership position to readily supply, without any regulatory restrictions, competitively priced, and EU compliant (substantial-equivalent) glucosamine products. Due to our superior manufacturing technologies, TSI offers a complete range of non-shellfish derived glucosamine ingredients that can be used in any current glucosamine formulation without any formula and process changes."

China Vows Cautious GMO

An official has stressed China's "active and cautious" policy toward genetically modified (GMO) food, with the safety certificates for the country's GMO rice and corn expiring soon.

The Ministry of Agriculture will continue to scrutinize the commercial production of GMO food, vowed Chen Xiaohua, deputy minister of the MOA, on Wednesday.

Chen's comments in response to a question at a press conference put the spotlight on the hot issue as the safety certificates for China's GMO rice and corn are scheduled to expire this year and their commercial production is yet to be started.

"By 'active,' I mean we will strengthen research and try to breed new GMO strains with our own intellectual property rights as soon as possible, so that we can take the lead in this field," he told reporters.

"By 'cautious,' I mean we will work to ensure safety in promoting and applying GMO products. That's why we have made strict laws and regulations and set up a whole set of safety evaluation mechanisms and a regulating chain involving various departments."

"Concerning the industrialization of research and development results, we will take the same policy," according to Chen.

Chinese authorities have set no timetable on the commercial production of GMO food, the deputy minister added. *(Source: Xinhua News)*

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