

Exploring opportunities in China's Food & Agriculture Business

Utilizing foreign technologies and expertise in the process of China's agricultural modernization

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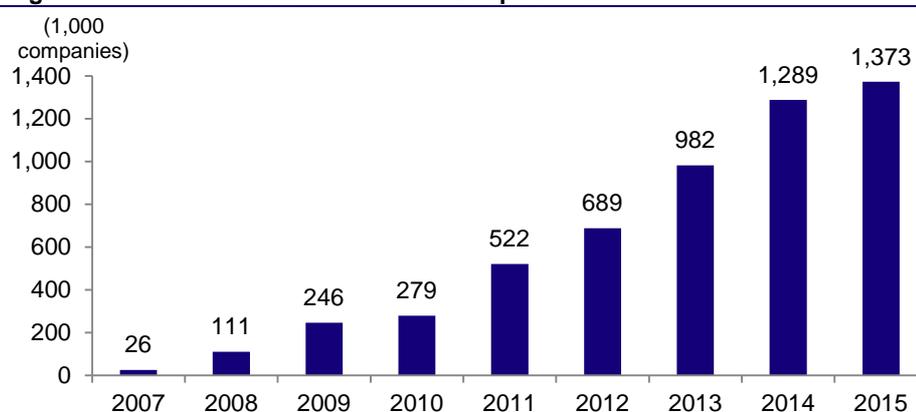
For more than a decade, the “No. 1 Central Document” – the first major policy document of each year released by the Chinese government – has underscored the nation's agricultural issues and promoted measures aiming at speeding up the process of “agricultural modernization”. Moreover, as income levels rise, the demand for safer, better quality food among Chinese consumers is increasing year by year. There are opportunities for foreign food and agriculture companies which are willing to utilize their technology and expertise in helping China to transform its agricultural models and to meet changing consumer needs. Given the importance of “linking added value to consumers”, cooperation with local companies that have networks with connection to either the users of such technology and expertise (i.e. commercial farmers) or the beneficiaries (those who will bear the cost thereof, i.e. consumers), is considered crucial for developing a successful business model. This report examines recent changes in China's food and agriculture industries, policy developments, and trends among the relevant players, primarily from the perspective of agricultural-related technology and expertise. It also explores the strategic directions for foreign companies that are looking to do business in this sector.

Changes and challenges in China's food and agriculture business environment

The most conspicuous supply-side change of recent years has been amongst the producers of this industry. China's rural population has been declined for many years and its agricultural labor force is aging and shrinking concurrently.

At the same time, in 2007, the government enacted a law pertaining to “farmer professional cooperatives”¹, which provided the modalities for legal farming entities and led to the formation of 26,000 cooperatives in the first year, with that number topping 1 million in 2014. These cooperatives are rapidly becoming the driving force behind agricultural modernization in China (Figure 1). There has thus been a gradual shift among the producers on the supply side of China’s agricultural industry from individual farmers to organizational units primarily comprising such professional farmer cooperatives, which are under the process of rapid development. Improving overall production efficiency through large-scale production is a major challenge for China, and the development of organizational units is expected to continue over the coming years.

Fig. 1: Number of Professional Farmer Cooperatives



Source: Prepared by Mizuho Industry Research Department from China’s State Administration for Industry and Commerce (SAIC) data, etc.

As to consumer-side changes, rising incomes have brought changes in consumer needs. Because of the frequent threats to food safety in China, middle and high net worth individuals are increasingly looking for high quality and safe food even if it is a little more expensive to purchase. Chinese consumers are increasingly demanding with food quality due to word-of-mouth communication on the Internet. As the middle and high net worth population in China is growing several times faster than in Japan, meeting the needs of demanding consumers is another major challenge for China to overcome.

To observe Policy directions from the No. 1 Central Document

At the beginning of every year, the Central Committee of the Communist Party and the State Council releases a policy document known as the “No. 1 Central Document”, which lists priority issues for the year. It has focused on agricultural issues for thirteen consecutive years (i.e. from 2004 to the most recent document of 2017; Figure 2).

¹ The rural cooperatives that were formed on the basis of the management principles and rules on establishment and registration thereof that are set forward in the “Law of the People’s Republic of China on Farmers’ Professional Cooperatives”. The scope of professional farmer cooperative business is extensive, from production only to integrated production and processing.

Fig. 2: No. 1 Central Document Themes since 2004

No. 1 Central Document Themes	
2004	Opinions on boosting farmers' incomes
2005	Opinions on strengthening rural work foundations and improving the overall production capacity of agriculture
2006	Opinions on constructing a new socialist countryside
2007	Opinions on developing modern agriculture and steadily promoting the construction of a new socialist countryside
2008	Opinions on infrastructure expansion to fortify the foundations of agriculture, agricultural development and raising farmers' incomes
2009	Opinions on achieving steady agricultural development and sustained income increases for farmers
2010	Opinions on speeding up coordinated development between urban and rural areas and further cementing the foundations of agricultural and rural area development
2011	Decision on accelerating water conservation reform and development
2012	Opinions on promoting the creation of agricultural science and technologies to sustainably strengthen the supply of agricultural products
2013	Opinions on promoting the modernization of agriculture and further strengthening the vitality of rural growth
2014	Opinions on the comprehensive deepening of agricultural reform and promoting and accelerating agricultural modernization
2015	Opinion on stepping up reform and innovation and accelerating the construction of modern agricultural models
2016	Opinions on implementing a new development concepts and speeding up agricultural modernization to realize the overarching goal of achieving a moderately prosperous society
2017	Opinions on promoting supply-side structural reform in agriculture and accelerating the cultivation of new growth engines in agriculture and rural areas

Source: Prepared by Mizuho Industry Research Department from the Ministry of Agriculture and State Council press releases, etc.

China's "Three Rural Issues"² has been the overriding priority for the central government since the first half of 2000s. However, there are changes in policy measures from 2010, which shifted the focus from farmers and rural communities to "agricultural modernization" from 2010 onwards.

In a broad sense, "agricultural modernization" encompasses the leisure farms that fuse tourism and agriculture. According to "No. 1 Central Document" of 2016, the Chinese government appended four modifiers to the term "agricultural modernization": high productivity, product safety, resource conservation, and environmental friendliness. China reoriented its policy towards the fundamental goal of upgrading the Chinese agricultural industry. Agriculture is also identified as a key sector in "Made in China 2025" and the "Internet Plus" strategy, both of which were unveiled in 2015, and target modernization through the mechanization and digitization of the industry.

² In China, the term "Three Rural Issues" refers to three issues: structural issues in agriculture (i.e. micro-management, low productivity and a shrinking population of farm laborers), the disparity of economic and social development in urban and rural areas, and the income gap between rural and urban populations.

Raising farmers' incomes and developing both rural communities and the agricultural industry through the agriculture modernization will ultimately help China to resolve its "Three Rural Issues" and achieve "an all-round well-off society", a goal identified in the 13th Five-year Plan for Economic and Social Development.

The theme of the most recent "No. 1 Central Document", which was released at the beginning of 2017, is "Opinions on promoting supply-side structural reform in agriculture and accelerating the cultivation of new growth engines in agriculture and rural areas". This document marks a departure from the "agricultural modernization" process of recent years and works on the premise of ensuring food security whilst aiming to build an agricultural industry that is capable of responding to market needs in areas such as mode of production and food safety. In other words, the government sets out to promote supply-side reform in light of changing consumer needs, with both sides being given equal importance in policy terms. It can be interpreted as the shift from an exclusive policy focus on supply-side issues to measures that incorporate the needs of consumers (i.e. the market).

The Chinese players pushing for agricultural modernization and their initiatives

China's farmer professional cooperatives were discussed above, but there are other players driving China's bid for agricultural modernization, namely "national key leading enterprises". In its bid to promote agricultural industrialization, the Chinese government has authorized "national key leading enterprises" that meet certain requirements in terms of sales and other management indicators, to serve as the driving force of agricultural industrialization. As of September 2014, the government had selected some 1,200 enterprises to act as drivers, with the hope that these enterprises will bind and promote the process of producing, processing and selling farm produce into an organic whole.

Another move that attracted considerable attention is the buyout by ChemChina, a Chinese state-owned chemical company, of Syngenta, a Swiss-based agrichemical business. The acquisition of Syngenta, the world leader in the agrichemical and seeds sector, is not only a deliberate bid to make agricultural (biotechnology) science a major new business in China, but also a bid to make a major contribution to raising the standard of Chinese agricultural technology. It is worth mentioning that the "Beijing-Tianjin-Hebei Alliance for Innovation in Modern Agriculture Research Institute" established in 2015 is another trend in industry-government-academia cooperation. The founding members of this research institute comprise national key leading enterprises, agricultural science academics and agricultural universities in Jingjinji Metropolitan Region, i.e. Beijing-Tianjin-Hebei, the national capital region of China, which was established with a view to creating a platform for scientific and technological innovation and entrepreneurship in the field of modern agriculture that will have global influence in circular agriculture, seed-related businesses, smart agriculture and other related fields.

These two initiatives are regarded as examples of state-owned enterprises and national key leading enterprises that are effectively reflecting government policy on agriculture. Private sector companies are also working to promote agricultural modernization. A number of new entrants from other industries are introduced below.

In the fall of 2015, leading Chinese e-commerce company, Alibaba Group, signed a memorandum of understanding with AGCO Corporation, a leading American agricultural equipment manufacturer, on the formation of a strategic partnership. They announced that large farm machinery would be available for purchase on “Taobao”³, a first for an online platform. Apart from farm machinery business, Alibaba Group has also announced plans to utilize big data for consultancy services and agricultural equipment and facilities, and to extend its cooperation to the loan business. Also, another leading Chinese e-commerce company, Jingdong Group agreed a partnership deal in the plant factory sector in June this year with Japan’s Mitsubishi Chemical Holdings, and announced its entry into the agriculture business. Jingdong Group will produce its own vegetables to appeal to freshness- and safety-conscious consumers. As this demonstrates, companies from other industries are also seeing China’s bid for agricultural modernization and changing consumer needs as good opportunities for business.

Strategies for foreign companies

There are plenty of opportunities for foreign companies to utilize the agricultural technologies and expertise they have accrued in home country. But with Chinese state-owned enterprises and leading private-sector companies from other industries such as IT and e-commerce pursuing business opportunities in this sector, foreign companies will need to formulate the strategies they take up.

“Making appropriate use of the technologies and expertise, and ensuring that the added value reaches Chinese consumers” is seen as a key to success in China’s food and agricultural market. No matter how excellent the technology or expertise is, the business will flounder unless that value can be delivered to consumers, and if the technology and expertise are not used appropriately it will fail to generate added value for consumers⁴. Networks with farmers, users capable of effectively utilizing the technology and expertise, and consumers seeking added value and willing to pay for it (the beneficiaries/consumers of such technology and expertise), are keys to the creation of a successful business model, and partnerships with local companies that have such networks are thus seen as critical.

The aforementioned partnership between Mitsubishi Chemical Holdings and Jingdong Group exemplified this strategy. Mitsubishi Chemical is providing

³ Taobao is a Chinese online shopping website and service platform that is operated by Alibaba Group that is designed to promote two-way e-commerce by supplying agricultural materials and consumer goods to rural areas and farm produce to urban areas.

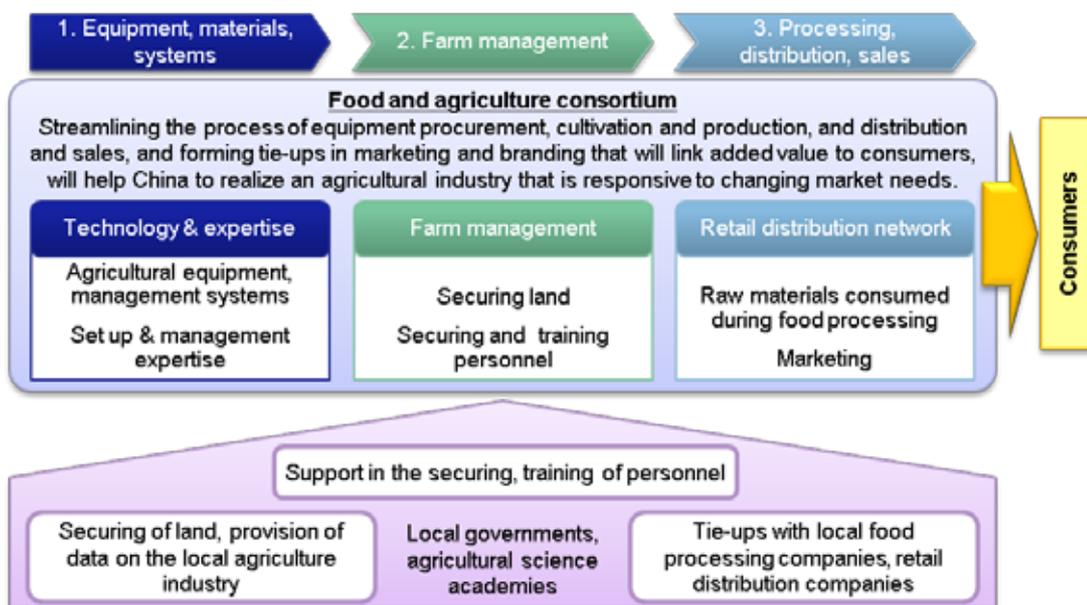
⁴ Interviews conducted in China reveal that Chinese consumers do not trust organic labeling in supermarkets and that vegetables have developed diseases after plant factory managers failed to abide by the rules.

the plant factory equipment and cultivation technologies, whilst Jingdong Group is producing the vegetables for sale via its own e-commerce website. The combination of technology and expertise of the Japanese company and the sales network of its local partner in an initiative allows the added value to be delivered directly to consumers without relying on third-party producers. Whilst limited in number, other similar examples are emerging, and their success/failure is drawing attention.

The ideal structure will be a consortium of these players working together closely and deliver the value added service to consumers: players with technology and expertise, players capable of utilizing technology and expertise, and players delivering the resultant produce to consumers (Figure 3). Additionally, support of public entities such as local governments and agricultural science academies in China is critical. Improvements of the technologies and expertise based on information obtained from consumers via the cooperation connects with agricultural modernization to deal with the change of market demand, the very policy the government presented in its No. 1 Central Document in 2017.

Foreign technologies and expertise can contribute to the realization of agricultural modernization and respond to the changing consumer needs in China. On the other hand, unlike the automobile and robotics markets, where China actively sought to adopt foreign technology, agriculture is fundamental to the national economy, and China may thus be reluctant to actively seek for foreign investment. Foreign companies looking to seize this business opportunity will thus need to act decisively and take the risk, bearing in mind the importance of partnerships with local companies.

Fig. 3: A Conceptual Diagram of a Consortium



Source: Prepared by Mizuho Industry Research Department

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