

China's wholesale steel markets are here to stay

In 2007 China consumed 408Mt of steel. The majority of that was distributed through an estimated 1000 steel markets – each with about 50 family-run shops carrying low inventories. Are these markets the future of the Chinese steel industry?

By Stefan Kracht*

A COMMON reaction during the first visit to a Chinese wholesale steel market is: *"It is an amazing situation unlike the rest of the world. But it will be gone in a few years."* The assumption is that consolidated sales channels such as distributors will replace steel markets. Yet since we first heard predictions of their passing, steel markets have only grown in size and importance. Their resilience explains much about China's distribution of steel and what the future may hold for the industry.

A wholesale steel market is a sight to behold – a motley assortment of traders, retailers, distributors and processors all thrown onto a small plot of land. A typical market is composed mainly of small shops ('moms & pops') anchored by a few large distributors. Goods are often stored in the centre of the market, creating what looks like a giant community-pile of steel. Any steel product can be found inside these modern-day bazaars. The China Iron and Steel Association estimates there are more than 1000 wholesale steel markets across the country. Most of them consist of around 50 small shops with large groups of workers. Some, such as the Lecong Steel Market near Guangzhou, are enormous: there are more than 600 stores and several regional distributors which make up a steel flow through of 4.5Mt/y – roughly 1% of China's total steel production.

Cost Structures

One important reason for the existence of steel markets is low cost: a tenant in Kunming's busiest market pays RMB20 000 (\$2925) rent a year for a 60m² shop. No electricity is used except when cutting with a saw. When it comes to other typical business necessities, let us say that they are 'light on overheads'.

To 'mom & pop' shops, minimising financial risk is paramount, so they keep low inventory levels. They may sell only 1000t in a year, and the amount of inventory on hand is just a small fraction of this – often only a few tonnes.

Further, most shops within steel markets are cash businesses which can yield hidden benefits. Few tenants pay VAT on their steel sales and invoices are difficult to get. Though the value-add of these stores is low, in a sector which extremely thin margins, the ability to bypass VAT is a major advantage over large distributors.



Lecong Steel Market near Guangzhou has more than 600 stores and several regional distributors and trades 4.5Mt/y, over 1% of China's apparent steel consumption

Pic ©FMC



The China Iron and Steel Association estimates there are more than 1000 wholesale steel markets across the country

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Trader mentalities

Tenants in steel markets must strike a difficult balance. Successful 'moms & pops' work with neighbours to achieve sales, but are not held back by cumbersome allegiances. Our observations of the flow of goods make the interdependence of these players clear. For instance, one of the more successful operators at a Tianjin market credited half of his success to his good relations with neighbours, with the other half based on his changing neighbours whenever his current ones outlived their use. This peculiar mindset is what gives the market such vitality. And it is this type of continually

adapting environment that helps make steel markets so resilient.

For the uninitiated, here is an example of typical steel market purchasing behaviour. If a 'mom & pop' shop receives a large order, say 100t, there is little chance the store can fulfil it on their own. Yet instead of turning it down, they will accept, in effect selling material they do not yet own. The seller will then work with their neighbours to find these goods. Often this process is done in front of the customer so it is possible to see two deals struck at roughly the same time. In this environment, market knowledge and strong relationships are the best assets.

It is not just individual stores that adapt quickly though: an entire market can transform as most companies have very little stock. This year tightened loan requirements have slowed property development, so that steel markets changed their stock since they cater heavily to the construction businesses. 'Moms & pops' within the steel markets were among the first to adapt, clearing out their already limited inventory of construction steel quickly; while larger distributors with large inventories were less fortunate.

Quality an issue

To the flood of Chinese wanting to start their own business, however small, a shop in a steel market still represents a good opportunity. Few businesses require so little investment, and steel remains a high-growth industry – so it is not difficult to understand why markets are full of tenants.

*Director China Consulting, Fiducia Management Consultants, Shanghai

This, however, is a key reason for the persistent problems facing this business. Tenants with little experience or few qualifications in evaluating steel quality nevertheless play an important role in the development of China's skylines and infrastructure. Many steel markets lack official oversight (other than security guards). Theft is not a problem, but unscrupulous dealing in low quality steel is. According to a Shanghai Daily article from March 08, 'half the steel material sold at wholesale markets and now being used in construction has failed quality tests.' It continues, 'The Shanghai Industrial and Commercial Administrative Bureau inspected 52 batches of steel material at three markets and 15 construction sites [...] and officials said 27 batches had quality problems.'

As long as mills are able to sell their lowest quality materials to steel markets, this issue will be difficult to resolve. And after visits to over 20 steel markets near Tianjin, Beijing, Shanghai, Kunming and Guangzhou, it is clear that quality issues are not an isolated problem. According to one interviewee, "if you want quality assurance here, you're going to have to bring your own inspectors."

Looking ahead

Taken individually, the shops that make up steel markets are not of much concern to large distributors. Yet as a whole, they are formidable competition. These shops have low entry barriers and operating expenses; they are



Most markets consist of around 50 small shops with large groups of workers

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Any steel product can be found inside these modern-day bazaars

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quick to adapt and have minimal oversight; and finally, they work directly with end customers – the most profitable part of the distribution system.

There is no doubt that these markets provide an efficient and cost-effective service to China's many small construction companies and SMEs. However, these markets also challenge traditional distribution channels and are willing traders of some of the lowest quality steel. Short of major market events or changes in government policy, these markets will remain a central part of steel distribution. ■

Fiducia Management Consultants

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Contact:

Nathan Jackson, Fiducia Management Consultants,
Suite 1908, Ciro's Plaza, 388 Nanjing West Road,
Shanghai 200003, PR China.
Tel +86 21 6327 9118 Ext. 502, Fax +86 21 6327 9228
e-mail nathanjackson@fiducia-china.com
web www.fiducia-china.com