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# Exploring the Obstacles of Latvian Food Companies Export to China

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## Abstract

As we know, China is the biggest trader in the world. European Commission has revealed that China has become the European Union (EU)'s second largest trading partner behind the United States, and EU is China's biggest trading partner. This situation just proves the necessity of making good partnership with China, which is especially needed for such a small country as Latvia. The main export fields for Latvia are wood, metal, electrical devices and minerals. As the population of China is growing very fast, leading to more than one billion people in 2016 (increased for more than 41 million in last six years), the food market is in need of more and more products. Of course, Chinese market may seem a golden ticket to each food producer, but there are some obstacles that doesn't allow European companies export to China right away. Some researches about cultural background differences and understanding how the Chinese partners work are still missing. In this fact, based on the statistics from the Ministry of Foreign Affairs of the Republic of Latvia as well as sample food market research report of Latvian export to China, the authors introduce some of the legal and cultural obstacles (differences) that may stop food producers from entering Chinese market, and give some ideas to assist Latvian food small and medium-sized enterprises (SMEs) to analyze the overview of China's food market, explore the barriers to entry the market of China, and illustrate the market barriers. Meanwhile, the authors use descriptive and analytical method in some specific researches of marketing barriers, such as Intellectual Property Rights (IPR) protection issues, infrastructure and logistics, and food labelling to analyze the marketing strategy of opening the food market in China. At last, the authors provide some information and advices to Latvian and EU's food producers to discover China market.

**KEYWORDS:** export; China; food industry; obstacles; regulations

## Introduction

China is also the world's second largest economy, and is the largest exporter and second largest importer of goods all over the world. The development of China as a major global economy was boomed by its World Trade Organization (WTO) membership in 2001, which made it reform and open up its economy. Just two decades ago, China and the EU traded almost nothing. However, today we form the second-largest economic partner in the world. In a obviously short time frame, also the EU economy has integrated to a point where it is difficult to imagine one without the other. The bilateral trading reached 429.7 billion EUR in 2013. However, trade in services is still about ten times lower at 49.9 billion EUR (2012 data) and remains a level full of potential market if China were to open its market more. How to open this large market successfully becomes a very important question for EU and their SMEs, and we need to solve this problem currently.



The purpose of the study is to investigate the obstacles of Latvian food products export to China, and do some specific research of exporting barriers such as registration of food & drink exporters, the new food safety law in China, new regulations on exports of dairy products to China. Based on the research of Latvian food company export, the authors analyze the marketing strategy of China food market. Meanwhile, the authors provide some information and advices to Latvian and EU's food producers to discover the food market in China.

To achieve the aim, there are three tasks solved in this paper. First, the authors analyze the overview of China's food market identifying market scale of China, market growth drivers in China, and forecasts of Chinese food market. Second, we explore the barriers to entry the market of China identifying legal and regulatory barriers, certifications, and standards of the food export to China. Third, the authors illustrate the market barriers such as distribution, infrastructure and logistics, economies of scale, and increasing local competition.

Novelty of the paper: some researches about China's imported food labelling regulations are still missing. In this matter of fact, made analysis in this paper creates the minimum requirement of information. Also the personal relationship with distributors, importers, officials, agents and some clients is important to help those food exporters overcoming unexpected obstacles. Most researches neglect this important factor, so in this paper, as a Chinese researcher, the author also illustrate how to work with Chinese partners well.

The article uses descriptive and analytical method of analysis in the research, such as official documents and law regulations, secondary analysis and synthesis of official statistics and information, analysis of scientific literature.

The People's Republic of China is located in eastern Asia and it is the third largest country in the world. Beijing is the capital of China – one of the most populous cities in the world (19.6 million population). China's GDP growth in 2013 was 7.7 %, and international estimates predict that China is on the track to become the world's biggest economy within the next ten years, with an internal market of 1.38 billion potential consumers by the end of 2016.

In 2014, the volume of exports of goods to China amounted to 107.2 million EUR which is by 27.3% more than in the year of 2013. In 2014 the volume of import of goods from China amounted to 353.09 million EUR which is by 4.7% more than in the year of 2013. The relative statistics data is shown in Chart 1.

The main goods exported to China are electronic equipment (18%), wood and wooden products (34%), metals and metal products (20%), machinery and mechanisms, and agricultural and food products (10%). The relative data of statistics is shown in Chart 1 below. Imports are dominated by machinery and mechanisms; electronic equipment (54%), products of the chemical and allied industries (12%) and light industry commodities (8%). Since 2008, the export to China has grown almost six times. At the same time the import from China to Latvia increased not even two times and was valued a little more than 354 million EUR in 2014. This fact can be beneficial for Latvian farmers and food producers. Also, this is an opportunity to boost the regional market and show a good case to other Baltic countries and maybe even some other EU countries in general. In 2014, for example, Latvia as the first of the Baltic countries had the permission to start the export trading of milk products to China. From 2010 to 2013 the sales of imported milk products in China increased 13 times, leading to 194.9 thousand tones of sold products.

With a unique cultural and geographical position, Latvia is providing a strategic location for international trading operations to develop the economies of the EU and emerging markets of Baltic neighbors. Latvia is a natural gateway between EU, the United States (US) and Asia (especially

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## Overview of China's Food Market

Russia and CIS). Some advantages enabling successful trade include advanced transport infrastructure, free trade and export experience and support.

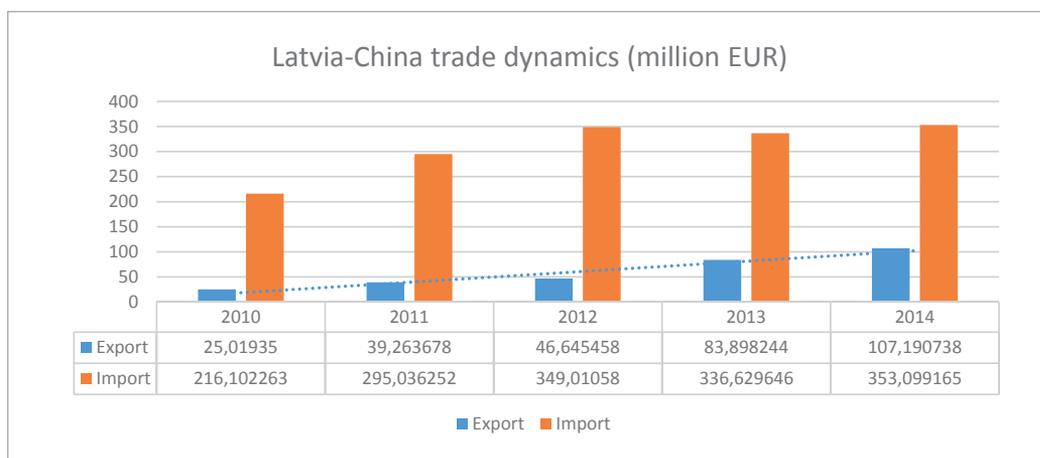
Located on the Baltic Sea, Latvia has three major, ice-free international ports (Riga, Liepaja and Ventspils) that are closely linked into the country's land-based infrastructure, including an extensive railway, road and pipeline system. The largest airport in the Baltic countries is Riga International Airport – with over 70 international direct destinations, it serves nearly two-thirds of all flights in these region.

External trade of Latvia and customs policy are based on free trade principles. Latvia is also a EU country, a member in Schengen district and an active participant of the World Trade Organization, getting all the benefits from free and open trade in the international markets. Customs and border procedures have been standardized for effective planning and cooperation with trade members in the world.

Some domestic food companies continue to develop their exports, making an environment of knowledge and ability that enable firms to grow their businesses abroad. Latvia's history has prepared its workforce with knowledge of business and cultural norms that enable trading members with Western European countries, and particularly with Russia and some Commonwealth of Independent Countries. Investment and Development Agency of Latvia (LIAA) provides a series of suggestions assisting registered domestic food companies to find and cultivate new markets.

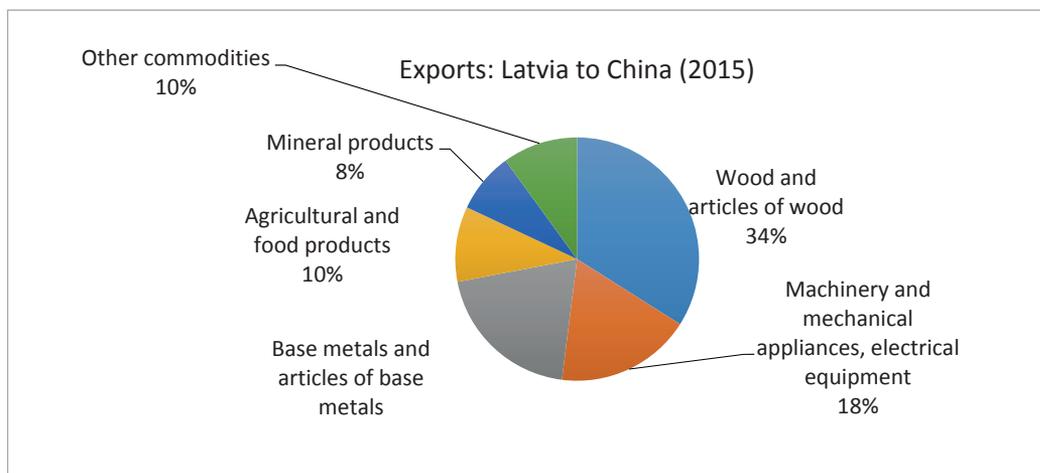
**Figure 1**

Trade Dynamics of Latvia and China (Source: Ministry of Foreign Affairs of Latvia, 2015)



**Figure 2**

Latvian Export to China by Commodity Sections (Source: Ministry of Foreign Affairs of Latvia, 2015)



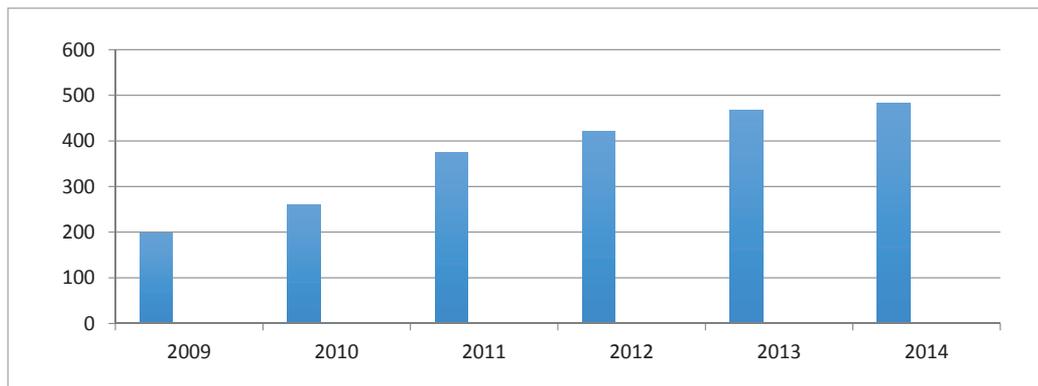
### Consumption (F&B) Growth in China

With an average annual growth rate of 30% from 2010 to 2014, China is the second-fastest growing food and beverage (F&B) market in Asia (stated in a study conducted by “The Economist”). According to “Euromonitor”, the Chinese food consumption sector is the largest worldwide whose turnover gets around 440 billion EUR in 2014 and 7.4 million EUR outlets.

With Chinese citizens consuming around 80kg of grains and over 100kg of fresh vegetables, respectively, per household in 2015, vegetables and grains are the most consumed food products in China. Notwithstanding their significance, the consumption of these two food categories has declined since 2010. In contrast, meat (beef, pork, and mutton), poultry products, aquatic products, milk and fresh fruit grew in popularity between 2010 and 2015, albeit at a modest rate.

Based on the observation in Chinese food market, the imported food quantities in China have increased obviously since 2012. It is well known that the recent rise in family disposable income and scandals on food safety have become the key drivers that have expedited rapid growth in China’s imported food market. Chart 3 below shows the trade value of imported food from 2005 to 2014.

In fact, data released by the Chinese National Bureau of Statistics show that the average annual income per capita in China’s urban households rose from EUR 308 in 1990 to EUR 3,791 in 2012,<sup>3</sup> allowing Chinese consumers to spend more on food (including imported products) and dining out. Food safety scandals include the 2008 tainted milk scandal, the 2013 discovery of 15,000 dead farm animals in the Huangpu River and, more recently, scandals in fast food chains. These incidents have substantially undermined Chinese consumers’ confidence and trust in domestic food production processes and standards. Food safety has a significant influence on consumers’ purchasing decisions.



**Figure 3**

China's Imported Food Trade Value 2005–2014 (in USD 100 million; Source: Commerce Ministry of China, 2015)

### Market Growth Drivers in China

A key growth driver in the Chinese economy has been the rapid rise in average household incomes. Over the past ten years, China has experienced an average **Gross domestic product (GDP)** growth of approximately 10%, which has created a new middle-income group with much higher disposable incomes. In addition, Chinese urban populations have increased by an estimated 153 million over the past ten years (2005–2015); by 2025, it is expected that urban areas will grow from 607 million to 822 million people. China’s major cities – Beijing and Shanghai – will continue to be leading consumer hubs. Beyond Beijing and Shanghai, McKinsey predicts that by 2015, nine large Chinese markets will account for 30% of luxury consumption in China: Chongqing,

Dongguan, Foshan, Guangzhou, Hangzhou, Nanjing, Shenzhen, Tianjin and Wenzhou. Luxury consumption will clearly include luxury F&B products, as well as consumer goods.

At the same time, rapid developments in transportation (including major rail improvements and road arteries) are expanding the economic potential of second- and third-tier cities. In terms of F&B, infrastructure improvements are speeding up distribution times, efficiency and costs, thereby stimulating local economies by raising consumer demand for higher value products. Cold-chain infrastructure remains poor, greatly affecting distribution of frozen foods. Due to China's rapid urbanisation, the number of urban residents is expected to reach one billion by 2030. Urban residents' steady consumption growth of basic ingredients over the last 20 years reflects the rising proportion of income spent on food and eating out.

**Future Outlook and Forecasts of Chinese Food market**

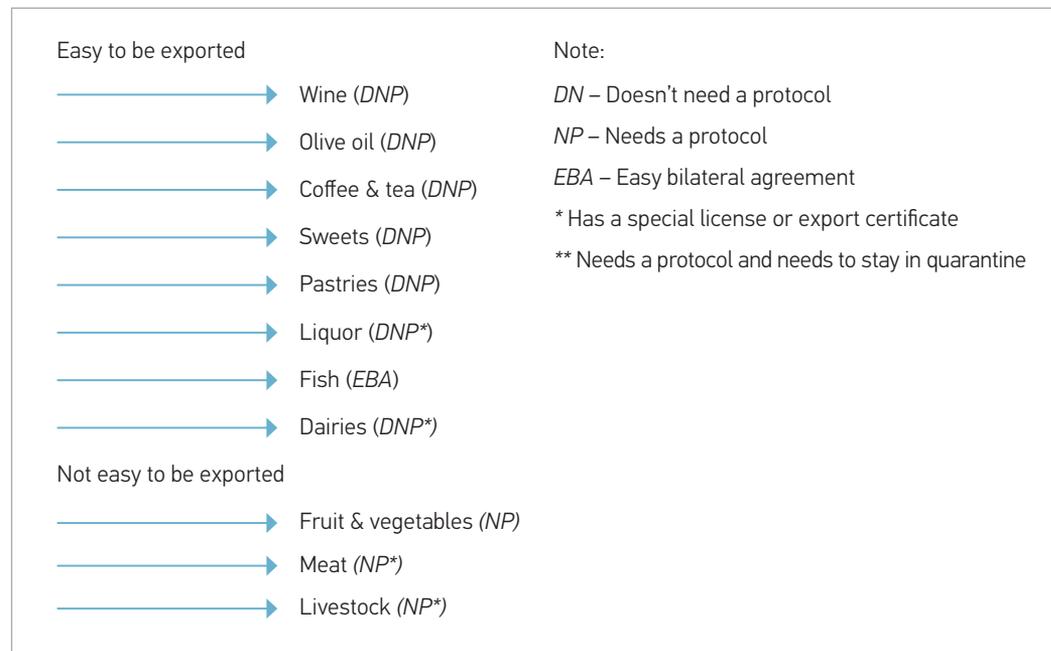
With a population of over 1.3 billion, China has emerged as the world's largest consumer market for F&B, surpassing the United States. By 2018, the Association of Food Industries predicts that China will be the world's largest consumer of imported food. According to "Euromonitor", the Chinese food service sector is now the largest in the world, with a EUR 440 billion turnover in 2014 and 7.3 million outlets. China has an increasing demand for protein, dairy and meat products, including chicken, beef, pork and animal offal.

**Legal and Regulatory Barriers**

Chinese F&B market is attractive due to the size of it, but many opportunities remain difficult for Latvian SMEs to exploit. There are multiple reasons for this, including high entry barriers related to the legal and regulatory environment, the characteristics of the market and the operating environment for both exports and investments entering China. Recently, China has approved some new regulations relating to certain industries, such as dairy, due to the food safety scandals (for example, Sanlu Milk Powder, injected meat, toxic food color etc.) in the Chinese market in past years. In Chinese market, imported products are in the order from the least easy (Livestock) to the easier (wine).

**Barriers to the Entry of the China Market**

**Figure 4**  
The Varieties of Exported Food to China



Since joining the WTO in 2001, China has reduced tariffs on a wide range of imported products, but sanitary and phytosanitary restrictions (and, to some extent, labelling) continue to limit access to the market. Meanwhile, the new Food Safety Law that was approved in October 2015, requires stricter monitoring and supervision methods, tougher safety standards, and the recall of substandard products with harsh punishments for offenders. Enforcement of regulations is often not very well planned, creating confusion for exporters. The new Food Safety Law regulates:

- \_ Trading and Production of food and food additives
- \_ Packing materials, vessels, detergents and disinfectants for food and equipment used in food production
- \_ Food additives and food-related products used by food producers and traders
- \_ Safety management of food, food additives and food-related products
- \_ All imported food products, subject to the national food safety standards in China

Entering China's market, the market-entry costs are high – both the fees involved in mandatory certification and the resources required. In this area particularly high concerns are product registration, product expiry dates and labelling. In order to enter the Chinese retail market, all the food and beverage companies must receive a hygiene certificate from the local government where the products will be sold. Another problem is inconsistencies in the interpretation of regulations among officials at different product entry locations and whether they loosely or more strictly apply fines and penalties. Regulations tend to change with some frequency and without a warning. Adjusting these regulations can be expensive and time-consuming.

Since September 10th 2013, foreign food and beverage companies exporters to China have been required to register from Administration of Quality Supervision, Inspection and Quarantine (AQSIQ). Registration can also be achieved through demand companies. Both of the two ways can be accessed from <http://ire.eciq.cn>. This website includes guidance in both Chinese and English, enabling the foreign food suppliers to register by themselves. It is important that the Chinese importers' information must be filled out in Chinese language before getting through the registration procedure; therefore, those companies are suggested to work closely with their agents in China or trading partners to complete this process.

AQSIQ also introduced new administrative measures for the inspection, quarantine and supervision of imports and exports of dairy products, which have been in effect since 1<sup>st</sup> of May 2013. Details of these new measures can be found at: [www.defra.gov.uk/animal-trade/2013/cin-2013049/](http://www.defra.gov.uk/animal-trade/2013/cin-2013049/). Companies exporting baby formula products to Mainland China also must register with the authorities and according to AQSIQ. For more information on the import of dairy products into China, one must download the EU SMEs Centre guideline Importing Dairy Products into China, available at <http://www.eusmecentre.org.cn/guideline/importing-dairy-products-china>.

The foreign organic certification systems and certification systems in China have not been mutually recognized. Thus, internationally recognized organic products that have been certified only by an overseas organic certifying body or have not been certified in China can not be labelled as "organic food" or "in-conversion to organic" or some misleading labelling information purporting to be organic when marketed in Mainland of China. To ensure the quality of imported organic food and reinforce the regulations on organic food producers, Chinese authorities have figured out that they will verify consignments in accordance with the Regulation on the Administrative Measures on Organic Product Certification and the Accreditation and Certification.

### **Certifications & Standards**

As the certification cost is determined by the process of inspection, the certification cost can vary. For example, it will increase the cost of certification if a variety of laboratory tests are required. And the

inspection can cost up to 2,790 EUR per product on average. However, if more tests are required, there will be added costs. About this cost, additionally, those companies willing to seek organic certification will have to pay the travelling and accommodation expenses to the Chinese inspectors visiting to inspect the food quality suitability. Organic certification needs to be renewed each year. Fees, however, are reduced by nearly one-third during the recertification procedure.

Since joining the WTO in December 2001, China has modified or introduced hundreds of food and agricultural-related standards and regulations. These have included the food additive regulations, the changes in food laws, labelling requirements, multiple commodity regulations, commodity-specific regulations, packaging and container requirements, and specific procedures. Following regulations are the key requirements that must be met by food that will be imported to China.

According to China's imported food labelling regulations, it is essential that all imported foods and beverages need to have a white label attached to individual cans, bottles or packets in simplified Chinese. Labels also must be checked by the Chinese Inspection and Quarantine Service (CIQS). And the regulation requests that products must be labelled before shipping, but as this will be difficult to carry out, CIQS allows labelling to be taken in bonded warehouses in China.

The following is the minimum requirement of information to be listed:

- \_ Configuration and net weight
- \_ Quality level
- \_ The product standard code
- \_ The number of food production licence
- \_ Standard name of food products
- \_ Address, name and contact information of manufacturer and distributor or local agent
- \_ Production date, use by date in YY/MM/DD format and guidance for storing
- \_ Generic name of the food additives as per the national standard
- \_ Ingredients list
- \_ Quantitative ingredients labelling (percentage)
- \_ Special contents if there are any (e.g. irradiated food, genetically modified, nutrition list for baby food or diet food)

Customer Information Quality (CIQ) requirements sometimes change and can be complex to interpret. Latvian food companies are proposed to reconfirm labelling requirements and other food products certification with the Chinese agents (or related departments), prior to dispatching goods. Stricter and tighter regulations are being strided over food and beverage categories in response to food safety concerns. Before importing, Latvian food SMEs must register with the Chinese Ministry of Commerce (MOFCOM) and are well advised to check with the Accreditation Administration and Chinese Certification if products also are needed for producer registration. To clear customs, a Latvian SME's first shipment of pre-packaged goods needs to:

- \_ Acquire a CIQ sanitary certificate
- \_ Meet the requirements of declaration at customs
- \_ Acquire a CIQ certificate of imported food labelling verification for the product's label in Chinese language

The following documents are also required:

- \_ Documentation providing permission to manufacture and sell the food product in the country or a region
- \_ Documentation supporting the application of label verification

In addition to regulate verification application materials of labelling, first time food exporters are

also required to submit:

- \_ The commercial licence copy of distributors, importers or agents that are listed in tags
- \_ The Chinese label sample of pre-packaged food or beverage
- \_ The original labelling sample with a Chinese translation

When pre-packaged food labels state that a product is award winning, certified, from a certain geographical region, or that it contains some special ingredients, corresponding materials showing proof should be provided. This information can be found in the following documents: "Export and import of pre-packaged food label management regulations and inspection supervision" No. 37 Notice of 2013. On the label, ingredients such as sugar or herbs must state specific types. Label verification from CIQS usually takes two to three weeks. This process is generally handled in contact with the distributor or importer, due to language issues and the need for cooperation with CIQS.

Counterfeiting is popular in some markets in China. Although vigilance is always necessary in the food and beverage companies, well-known international brand products experience more problems than do smaller producers. Recently, the serious cases of wine adulteration and counterfeiting have highlighted the issue across the broader wine sector. The sheer amount of European "Alcohol" in Chinese market alone raises some concerns regarding the original production place. For further guidance on IPR-related issues, the China IPR SME Helpdesk may offer you with confidential, free-of-charge, commerce-focused IPR advice.

In the system that has a transparent series of well-understood procedures, more or less it is easy to place a product on the market of China. However, the personal relationship with distributors, importers, officials, agents and some clients is important to help those food companies overcoming unexpected obstacles. Due to the legal system, it is developing but remains inconsistently helpful and applied. Thus, enforceability of some contracts vary widely but also is generally a little weak. Doing a successful business in China relies heavily on influence (guanxi) or personal contacts. Generally, we can see that no investment will be more important to Latvian food SMEs' success than the available network of relationships they build in China.

### **Distribution**

The imported food markets remain more or less decentralized in main land of China and these markets are described as competition and free growth. Meanwhile there are not too many large distributors or agents that are dedicated to imported food and beverages. As there are few importers or agents with more than 1,200 imported food and beverage products, the varieties of European imported products in China are very limited. Most Chinese agents in this market are more willing to be interested in wholesaling and do not like to pay more attention to brand development, so some distributors or agents tend to be conservative in introducing the new imported products to Chinese customers. Generally they pay more attention on the products that have already been sold in the market but are sold by "grey" channels (not official) or sub-distributors. Some European food suppliers with a limited range of products need to work not only in the ends of the distribution chain simultaneously, but also to identify some retailers who are interested in the products and agents who have good relationship with lots of retailers.

Because of the domestic food scandals and growing disposable income in China, the dramatical development of online shopping (Such as Taobao) has been a main driver to stimulate the boom of the imported food selling. The internet shopping market has expanded sharply since 2013, which has resulted in the closure of some food retail shops due to the increasing preference of online shopping consumers. According to a marketing research, when considering online shopping channels as a way of distribution, a new internet marketing portal in China, Latvian food companies which are going to open Chinese market should be aware of the following details:

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## **Market Barriers to China Market**

- \_ It is easy to have conflicts of interest among the marketing channels
- \_ There are lots of requirements for logistics and warehousing
- \_ High brand promotion costs are associated with using e-commerce platforms
- \_ The costs of distribution are generally high
- \_ Online shopping habits are different from traditional consumption habits, especially for snacks

### Infrastructure and Logistics

The first tier cities in China such as Beijing, Shanghai and Guangzhou are the main entry points from EU to mainland of China. Compared to just several years ago, China Railway High Speed system has greatly eased the cargo directly out of Guangzhou or Shanghai. China High-speed train has decreased the time travelling across the country; in the Changjiang River Delta, for example, trains from Shanghai to Hangzhou City (Zhejiang province) now take not more than thirty minutes and, to Nanjing City (Jiangsu province), less than forty minutes. As increasing high speed railways are important distribution networks, the government is continuing to support the rail network with further investment. China has the largest container ports in the world, with Shanghai holding the world's top spot since 2009. In the region of Guangzhou, Hongkong and Shenzhen, container ports are ranked respectively at numbers three and four all over the world, and there are also three other ports (such as Qingdao, Tianjin, and Dalian) among the largest ten in the world. The process of exported food logistics is illustrated in Figure 5.

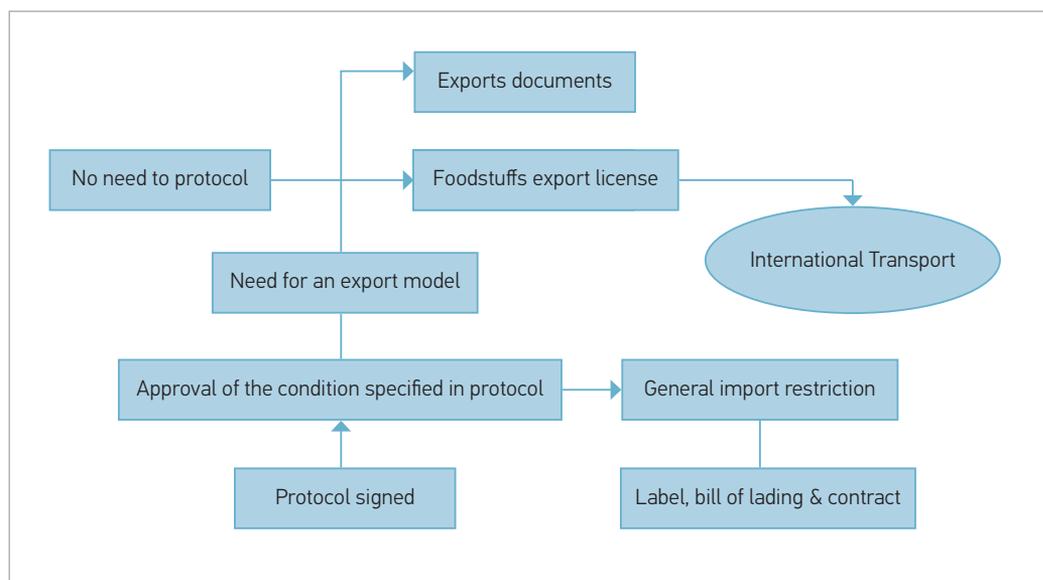
In neighbor cities, ports offer a growing series of services, including bonded storage with online inventory tracking, temperature-controlled services, and tax free industrial regions where goods can be further processed or repackaged, with tax paid only on the original import value and only after products depart from the area. However, further inland logistics services are local, inefficient and fragmented, making it difficult to transport imported food directly from the coast cities to inland cities. Demanders in China are not familiar in this kind of transportation yet.

### Economies of Scale

Over the past four years, China's GDP growth has been 8% per year on average, and GDP per capita reached 89 trillion EUR (63.6 trillion RMB) in 2014 (7.4% growth). Organic producers face the challenge of scaling up their production capacity to meet large scale of Chinese demand, especially those with a geographical indication (GI) mark as well as sufficient production volume to

**Figure 5**

Process Map at Origin of Export (Source: EU SME Centre ,2012, Export of goods to China)



make a profit. Meanwhile, their GI status and the quality of their products depend on their small production capacity; it means China is a very large market, and if one product is successful on the market, the demand will grow beyond its production capacity. Given the difficulties of entry and costs involved, it could be a challenge to make the market entry profitable. Local companies may make the process of production and marketing more efficiently. French and German companies have had some success by producing goose liver and breeding geese in partnership with Chinese producers locally. There is a local company which has established a Spanish-style ham processing company that employs Spanish employees and is labelled as Spanish brand.

### Increasing Local Competition

Latvian food products are regarded as high safety standards and healthy production quality, but their prices are often more expensive than some local food products. In terms of food marketing competition, the United States keeps the largest food supplier of consumer-oriented products to China, and it is the only one exporter with a present goods in most varieties.

Therefore, local food companies seem to repel imported products out of the price-oriented mass market and into their own markets, where innovations and qualities are more important than price. In a few years ago, some Chinese restaurants and hotels were usually obliged to import European products as their specialties; however, they are now able to turn to local producers. For example, some Latvian dairy companies, such as "Daugava, VALMIERAS PIENS, DRUVA FOOD", sell cheese directly to restaurants and hotels, and also some local companies are also making European-style meats and other dairy delicacies. Some companies express concern that increasing local production threatens sales of their imported food products. However, the two companies can work in tandem to increase consumer exposure to new food products and allow consumers with more discerning tastes to access original and better quality food.

- The Latvian Foreign Ministry's State Secretary Andrejs Pildegovičs commended the successful Suzhou Summit and expressed appreciation for the opportunity of organizing this year's events in the "16+1" format. The organizational modalities of the upcoming events were discussed, as well as projects in logistics and transport. Thus, Latvian food producers will have better access to Chinese market in this fall. Also Latvian food companies will have more chances to export their production to such a large country that has a rapidly growing food market. Economic relations with China take on increasing importance. Economic relations and traditional markets do not always meet the best result. In the post-crisis time, the coming new challenges in the global economy new fields and channels for cooperation bring more and more opportunities. Even the most different economies can create synergy and opportunities for development. Generally, there are several steps for Latvian small and medium food companies to operate the export trading to Chinese market.
- *Step 1*: Check if you can export your product to China, *Step 2*: Check if an Export Model is needed and ready, *Step 3*: Check if your products meet Chinese Regulations, *Step 4*: Register as an exporter at AQSIQ, *Step 5*: Prepare documents to export, *Step 6*: Label your product following Chinese regulations, *Step 7*: Check if you meet Chinese regulations on packaging, *Step 8*: Import documents and licenses, *Step 9*: Customs Inspection, *Step 10*: Tariffs and tax payment.
- Thus, it is necessary to recognize cultural background differences and spend time understanding how their Chinese partners work. They also find that agreements viewed as contract by the Latvian food suppliers are more flexible or negotiable from the perspective of the Chinese demanders. Ensuring that a company representative is present at all transactions will reduce misunderstandings and errors. It also offers the opportunity to adapt suitable portion sizes, alter ingredients in the exported food products (for example, reduce sugar content), and design the packaging appealing to Chinese consumers. However, with the Chinese government put-

## Conclusions

ting forward the One Belt One Road strategy and the G20 summit held in Hangzhou, it is a good opportunity to solve the problems of investment and trade facilitation. Also Latvian food companies could take advantage of this background to carry out more trade and find investment barriers, building area and the good business environment for positive cooperation.

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#### **Fields of research interests**

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