Agriculture and Agri-Food Canada | Agriculture et Agroalimentaire Canada

MARKET ACCESS SECRETARIAT
Global Analysis Report

Business Environment

China

October 2014

EXECUTIVE SUMMARY

- The Chinese economy is one of the largest in the world, but real gross domestic product (GDP) growth has seen a continuous drop from the over 10% recorded in 2010, to 7.6% in 2013. The yearly real GDP growth is forecasted to remain at around 7% over the next few years.

- China is making efforts to move from an investment-driven economy to one that is consumption-based. This is seen as an important transition in order to for the country to continue its economic growth into the future.

- China's retail sector (grocery and non-grocery) was valued at US$2.5 trillion in 2012 and is forecast to reach US$4.9 trillion by 2018 (Planet Retail, 2014).

- Online retailing in the Chinese market reached sales of US$64.4 billion in 2012 following substantial growth (3,120%) since 2007. This channel is forecasted to see sales grow by a compound annual growth rate (CAGR) of 25% until 2018 (Euromonitor International, 2014).

- The foodservice industry was valued at US$510.8 billion in 2013, and is expected to show slowed but moderate growth over the coming years, reaching sales of US$745.2 billion by 2018 (Euromonitor, 2014).

- According to the World Bank Group, China ranks 96th out of 189 countries in terms of the overall ease of doing business in the country (2013).

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COUNTRY SNAPSHOT

The Chinese economy is one of the largest in the world, second only to the United States. China has a GDP of US$9.3 trillion and the largest population in the world with just over 1.3 billion people. Since 2010, China's real GDP growth rate has slowed steadily, and this trend is forecast to continue through 2018, when real GDP growth is expected to drop to just below 7% (Euromonitor International, 2014). The agriculture sector employs 35% of the workforce and makes up 10% of China's overall GDP (CIA World Factbook, 2014).

Over the last number of years, China has been trying to move the economy towards consumption. While it has made progress in this direction, China is now turning back towards investments in order to head off the risk of a slowdown (Euromonitor, 2014). Going forward, China will need to continue reducing its dependence on investment and increase domestic consumption. To achieve this, the Chinese government is looking to increase the minimum wage over the next five years, in an effort to further develop the middle class (Euromonitor International, 2014; IGD, 2014). This increase will allow China to remain competitive, but could also have an adverse effect in terms of business expenses becoming more costly (Euromonitor International, 2014).

Historic Economic Overview – China

Indicator	Unit	2009	2010	2011	2012	2013
Total GDP	US$ millions*	5,629,155.9	6,501,372.6	7,627,973.4	8,541,796.3	9,353,685.3
Real GDP Growth	%	9.2	10.4	9.3	7.7	7.6
Inflation	%	-0.7	3.2	5.5	2.6	2.6
Exports	US$ millions	1,201,920.0	1,578,450.0	1,899,280.0	2,050,120.0	2,210,680.0
Imports	US$ millions	1,003,880.0	1,393,910.0	1,741,420.0	1,817,400.0	1,949,340.0

Source: *Euromonitor, 2014.*
***Note:** *Current prices, fixed 2013 exchange rate*

TRADE

China is an important market for Canadian exports. The Department of Foreign Affairs, Trade and Development Canada (DFATD) developed a Global Commerce Strategy identifying five priority sectors for Canada in terms of export opportunities to China: agriculture and agri-food; information and communication technologies; automotive, aerospace, and metals; minerals and related services; and equipment. These areas are where Canadian expertise closely matches Chinese demand (DFATD, 2014).

According to Global Trade Atlas, China is currently a net importer of agri-food and seafood products, and top suppliers include the United States (holding a 22.6% share in 2013), Brazil (19.1%), Australia (7.3%) and Canada (4.9%). In 2013, China's total agri-food and seafood trade deficit was C$52.4 billion with imports valued at C$121.5 billion, and exports of C$69.1 billion.

Canada's agri-food and seafood exports to China were valued at C$5.2 billion in 2013. Top exports were canola seeds and oil, fish and seafood, soybeans, and peas. In 2013, Canada imported C$1.2 billion worth of agri-food and seafood products from China, thus registering a large agri-food and seafood trade surplus (C$4.4 billion) with this partner country (Statistics Canada, 2014).

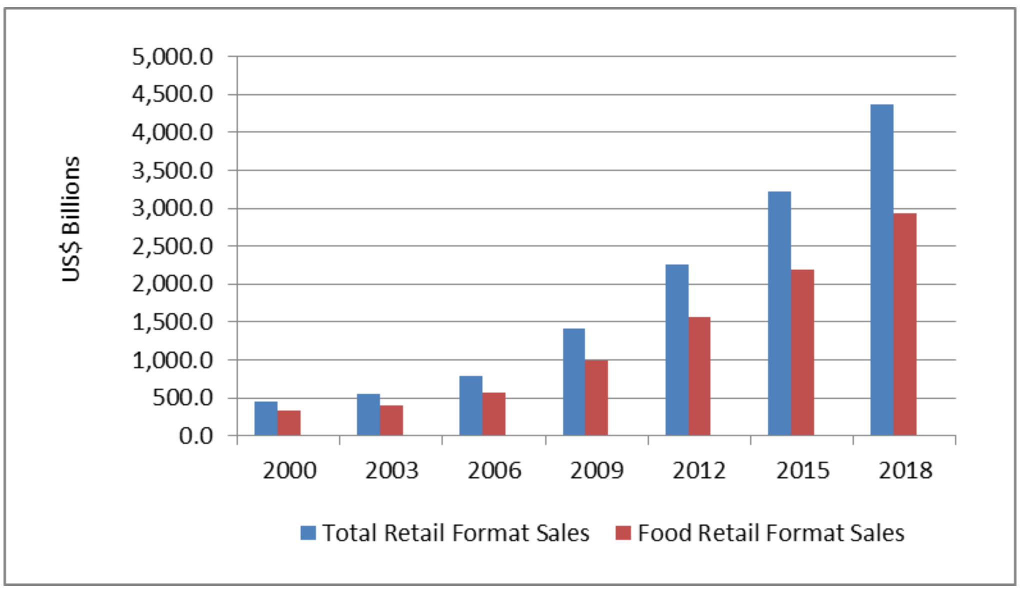
RETAIL ENVIRONMENT

China is the third-largest retail market in the world, behind the United States and Japan, and has a developed retail environment. However, it is highly fragmented, with an overabundance of small, often family-owned, independent operators comprising the sector. Three major cities (Guangzhou, Shanghai, and Beijing) dominate the market and are by far the most important regions for retailing (Planet Retail, 2014).

According to Planet Retail, China's total retail sector (grocery and non-grocery) was valued at US$2.5 trillion in 2012. The retail sector is estimated to have increased by 13.5% in 2013, and a further 12.6% is expected for 2014. Over the 2014-2018 forecast period, the sector's total sales value will continue its upward momentum with a CAGR of 11.2%, to reach US$4.9 trillion.

The grocery retail format accounted for sales of US$1.4 trillion in 2012, or just less than 58% of the total retail sector. Grocery sales are expected to increase in 2013 and 2014 year-over-year (by 12.7% and 11.8%, respectively). This growth trend is forecast to continue through 2018, albeit at a decreasing rate, reaching an increase of 9.8% from 2017 to 2018, and an expected sales value of US$2.7 trillion. The slowing year-over-year growth could be attributed to the maturity of the market and consumers shifting their spending to more non-essential items such as leisure and communications (Planet Retail, 2014).

Retail Format Sales in China, Historic/Forecast 2000-2018



Source: *Planet Retail, 2014.*

According to Planet Retail, a series of reforms have gradually eased restrictions in the retail sector. Foreign entry was limited to joint ventures and to certain areas until December 2004. Since that time, foreign retailers may own 100% equity in companies, and are not subject to restrictions on where they can operate geographically, how many stores they can have, or how large the stores are. However, all new store openings still must receive permission from the appropriate authorities to proceed, which can pose challenges in terms of time delays (Planet Retail, 2014).

The Online Channel

Online shopping is becoming vastly popular in China and is changing the way that retailing is done in the country. It is estimated that 65% of Chinese consumers currently purchase goods online. According to Planet Retail, women between the ages of 18 and 34 make up 52.9% of the total online market in China, and the top online spenders are women between the ages of 35 and 54, with around US$70.91 per month in total purchases (Planet Retail, 2014).

According to a study conducted by PricewaterhouseCoopers (as cited by Euromonitor, 2013), around 240 million Chinese consumers shopped online as of mid-2013. Of these, 60% said they purchased apparel, 39% purchased household goods, and 35% purchased digital and electronic products. Internet retailing was worth US$64.4 billion in China during 2012, up from just US$2 billion in 2007, and sales will continue to grow at a CAGR of 25% until 2018 (Euromonitor International, 2013).

Hypermarkets

As China's economic growth slows and consumers shift their spending on non-food products to the online channel, several of the major hypermarket operators such as Walmart, Carrefour and Tesco have suffered from slowing rates of sales growth in recent years. The success of online operators such as Tmall and 360buy has hit the hypermarket channel hard and is causing a major re-strategizing among key players. For instance, the Tesco banner is expected to disappear from the Chinese market in 2014 following its joint venture agreement with China Resources Enterprise (Planet Retail, 2014).

However, hypermarkets will likely remain the major growth format in Chinese retailing for the foreseeable future, as the major players continue opening new stores beyond the first-tier cities. Hypermarkets provide tough competition in many of the major cities and their success is attributed to higher volumes sales and the ability to charge lower prices than department stores and supermarkets (Planet Retail, 2014).

Top Companies in Grocery Retail

The Chinese retail sector is very fragmented, with the top five companies only holding a combined 2.5% market share, as shown in the table on the following page, suggesting an environment with good potential for new entrants. However, while there are no legal restrictions preventing the entry of foreign retailers into China, new store openings have to be approved by authorities (Planet Retail, 2014).

In terms of grocery banner sales, China Resources Enterprise (CRE), the largest hypermarket chain in the country, is forecasted to be the top retailer in 2014 with sales of US$13.4 billion and only a 0.7% share of the total market. CRE is furthering its expansion efforts in 2014 by entering into a joint venture with Tesco, which was approved in May 2014. CRE will also continue its expansion efforts by acquiring small local chains to accelerate its expansion and/or enter new regional markets. CRE is looking to achieve large-scale presence in as many regions as possible (Planet Retail, 2014).

As shown in the table on the following page, three of the top five retailers (Auchan, Walmart and Carrefour) are foreign and figure prominently in the Chinese retail market. Foreign retailers tend to have a smaller number of larger stores, are more experienced, and have greater buying power than the domestic players (Planet Retail, 2014).

Top Five Grocery Retailers in China – 2014 Forecast

Company	Number of Outlets	Total Sales Area (Square feet)	Average Sales Area (Square feet)	Grocery Banner Sales (US$ millions)	Total Grocery Market Share (%)
China Resources Enterprise (CRE)	4,649	84,133,953	18,097	13,374.1	0.7
Auchan	371	36,415,385	98,155	10,782.6	0.6
Walmart	436	59,145,535	135,655	9,642.4	0.5
Lianhua	4,595	33,830,971	7,363	7,625.1	0.4
Carrefour	256	21,366,621	83,463	5,026.3	0.3

Source: *Planet Retail, 2014.*

FOODSERVICE ENVIRONMENT

The Chinese foodservice sector recorded a CAGR of 11.8% from 2008 to 2013, reaching total sales of US$510.8 billion. The sector is expected to continue expanding, although at a slower rate, reaching total sales of US$745.2 billion in 2018. The sector has maintained strong sales, despite decelerating year-over-year growth rates since 2011, which are expected to continue across the forecast period to 2018. Weak economic performance, rising prices, and product safety concerns have all affected consumer confidence. According to Euromonitor (2013), this has resulted in more consumers prioritizing other expenditures over foodservice, and patrons are thus eating out less, and opting for cheaper or more value-wise categories such as fast food.

The industry is very fragmented and smaller independent operators dominate the sector, representing 91.3% of total foodservice sales in 2013. However, global chains have gained a foothold in recent years and are absorbing share as they expand rapidly alongside a savvy consumer base seeking more chained foodservice options. An industry-wide focus on branching into China's emerging second- and third-tier cities will further fuel this growth. The top chained brands in the market currently include Kentucky Fried Chicken (KFC), McDonald's, Dico's, and Pizza Hut (Euromonitor, 2013).

Historic and Forecast Consumer Foodservice by Type – Market Sizes in US$ Millions
Current Prices – Fixed 2013 Exchange Rate

Category	Market Value (US$ millions)			CAGR* (%)	
	2008	2013	2018F	2008-13	2013-18F
Total consumer foodservice	292,970.6	510,823.0	745,151.3	11.8	7.8
Independent consumer foodservice	270,251.1	466,451.9	670,629.0	11.5	7.5
Chained consumer foodservice	22,719.5	44,371.1	74,522.2	14.3	10.9
Full-service restaurants	213,094.4	374,720.3	533,697.2	12.0	7.3
Fast food	68,342.2	117,023.6	180,249.9	11.4	9.0
Cafés/bars	5,911.8	10,746.0	20,013.0	12.7	13.2
Street stalls/kiosks	5,299.9	7,686.6	10,139.0	7.7	5.7
Self-service cafeterias	277.2	536.4	867.3	14.1	10.1
100% home delivery/takeaway	45.1	110.1	184.8	19.5	10.9
Pizza consumer foodservice**	1,092.9	2,544.7	5,399.1	18.4	16.2

Source: *Euromonitor International, 2014* ****CAGR:*** *compound annual growth rate*
*****Note:*** *Pizza consumer foodservice is the aggregate of three sub-sectors: pizza fast food, pizza full-service restaurants and pizza 100% home delivery/takeaway. These three pizza sub-sectors are also already included within the fast food, full-service restaurants and 100% home delivery takeaway sectors.*

As shown in the table on the previous page, the full-service restaurants category is expected to remain dominant in China; however, its share of the total market is expected to decline in favour of other subsectors' growth over the forecast period, particularly fast food. According to the Canadian Trade Commissioner Service in China, there is a growing demand for American cuisine in the fast food channel, especially among younger consumers. American fast food chains offer modernized atmospheres in which to socialize with friends, and many younger consumers prefer these branded establishments for the status they represent. However, American-style foods are sometimes perceived as unhealthy by Chinese consumers, and traditional cuisine is still a preference for many. As a result, fusions of fast food fare with Chinese cuisine are also gaining in popularity. For example, menu adaptation to suit the local palate has been key to the success of KFC in the market – the chain serves options such as pork burgers, shrimp offerings, and rice dishes.

Over the 2013-2018 period, the fastest-growing foodservice subsector is expected to be pizza, which crosses several categories. Pizza will see sales increase by a significant CAGR of 16.2% as consumers seek the convenience, affordability and Westernized style of this particular cuisine. However, the fast growth of Chinese foodservice operators overall, may stimulate opportunities in several channels for high-end products and ingredients sourced from abroad.

More detailed information the foodservice environment can be found in the February 2014 Agriculture and Agri-Food Canada report entitled *Foodservice Profile: China*.

REGIONAL COMPLEXITIES

Due to China's vast physical size and population, there are significant regional differences in terms of consumer preferences and economic development. At a very basic level, rural inland areas are more domestically oriented. These regions are abundant in natural resources, but less advanced economically, and are thus home to lower-income earners who generally focus their purchases on essential items from traditional-style markets. In contrast, higher-income urban areas, particularly those along the eastern coast, benefit from more advanced infrastructure and trade networks. Consumers in these areas have a greater ability to purchase imported goods and specialized products, are more exposed to Western lifestyles and international cuisines, and have higher brand awareness. However, within these generalized regions, distinct cultural and socioeconomic characteristics also exist from city to city (AAFC, 2013; International Market Advisor, 2014).

Foreign business interest has generally emphasized a select few Chinese cities, including Beijing, Shanghai, Guangzhou and Shenzhen. However, as these markets become increasingly saturated, intensively competitive, and highly expensive in terms of operating costs, companies are refocusing their efforts on second- and third-tier cities as opportunities for development (International Market Advisor, 2014). While there is no definitive list of second- and third-tier cities in China, Promar Consulting (2012) suggests that Tianjin, Shenyang, Suzhou, Hangzhou, Dalian, Shenzhen, Qingdao, Dongguan, Nanjing and Foshan are the top ten second-tier cities with prospects for international food marketers. This ranking was based on a combination of factors starting with population size and GDP per capita, followed by an assessment of 10 additional criteria such as the city's growth potential, food imports, retail and foodservice sales, proximity to a major food port, and many others (Promar Consulting, 2012).

Overall, those seeking to enter the Chinese market must be aware of its regional, provincial and municipal complexities, as well as the breadth of opportunities to be found in each, in order to best position a product or service. Working with a local agent who could share tailored market expertise is highly recommended, from the early stages of any Chinese business venture (Sheets, 2013).

DOING BUSINESS IN CHINA

The World Bank's Ease of Doing Business report (2013) assesses the number of procedures and length of time it takes for a company to start a business. Measures range from registering a company to obtaining electricity, and the ease of paying taxes. In its latest report on 2014, China ranked 96th out of 189 countries, up three spots from the previous year. The increase in ranking was largely attributed to the inroads made in the getting credit score. According to the World Bank, China improved its credit information system during this review year, by introducing industry regulations that guarantee borrowers' right to inspect their data (2013). China also ranked a very strong 19th with regard to enforcing contracts.

Despite its increase in overall ranking, however, the Chinese market still poses business challenges according to the World Bank report, particularly in terms of procedural delays. For example, while the cost to import a container into China is almost half the OECD (Organisation for Economic Co-operation and Development) country average, the number of days required to complete this procedure is more than double. Similarly, while it costs less to start a business in China as compared to the OECD average, it takes three times as long (World Bank Group, 2013).

According to the 2014 rankings, dealing with construction permits is a significant burden when doing business in China. The country ranked close to last in this particular measure (185th out of 189), requiring 25 procedures and 270 days to complete, compared to the OECD average of 13 procedures and 147 days. The costs associated with construction permits in China are also four times higher than the OECD country average (World Bank, 2013).

Doing Business in China – World Bank Group Ranking 2013-2014

Measure	2014 Rank	2013 Rank	Change in Rank
Overall	**96**	**99**	**+3**
Starting a Business	158	153	-5
Dealing with Construction Permits	185	185	No change
Getting Electricity	119	116	-3
Registering Property	48	47	-1
Getting Credit	73	82	+9
Protecting Investors	98	95	-3
Paying Taxes	120	122	+2
Trading Across Borders	74	74	No change
Enforcing Contracts	19	19	No change
Resolving Insolvency	78	80	+2

Source: *Doing Business, World Bank Group, 2014.*
Positive change= Making it easier to do business. *Negative change= Making it more difficult to do business.*

It is also important to understand cultural differences between the business practices of western countries and China. Proper respect for business etiquette and customary practices can strengthen and finalize a deal. Relationships are paramount in Chinese business dealings, and trust is something that doesn't come quickly or easily. Due to the market's highly competitive nature, the general cultural approach is to mistrust potential business partners, or anyone outside of one's immediate network, until their trustworthiness is proven. As a result, building friendships is an integral element to doing business. Invitations to sporting events and dinners where everything but business is discussed, are customary precursors to official dealings with Chinese partners as a way to build trust and respect (Witt, 2012). However, even in these informal settings, always assume that you are being evaluated as both an individual, and a representative of your business (Kwintessential, 2014).

Furthermore, respecting "face" and the usage of proper mannerisms are very important in China. A modest, patient and polite demeanour is essential, as is remaining calm, collected and attentive during business discussions (Kwintessential, 2014; Stoller, 2013). Differences of opinion should not be voiced during meetings, even within your own team, as the cultural norm is an aversion to conflict. Similarly, saying "no" outright, or intentionally proving someone wrong, is perceived as rude and arrogant (Canadian Trade Commissioner Service, 2014). Finally, the exchange of gifts is regular practice in dealing with Chinese businesses, and must always be reciprocated (Kwintessential, 2014).

TARIFFS AND REGULATIONS

There is a value added tax (VAT) on almost all products in China, as well as a consumption tax on some products, which are assessed at the point of importation. According to the Canadian Trade Commissioner Service in China, the normal VAT rate is either 13% or 17%, depending on the product category.

Chinese import tariff rates are based on the Harmonised Commodity Description and Coding System (HS), as well as the origin of the goods. China has gradually lowered tariff rates since becoming a member of the World Trade Organization (WTO) in 2001, with the average tariff dropping from 15.3% in 2000 to 9.4% in 2013 (Canadian Trade Commissioner Service, 2014; HSBC, 2012; WTO, 2014).

China's tariff schedule outlines the following rate types:

- The **MFN tariff rate** is applicable to imported goods whose place of origin is a member country of the WTO.

- The **preferential tariff rate** is applicable to imported goods whose place of origin is a country or region that has concluded a bilateral or regional free trade agreement with China. The list of countries in which a preferential tariff rate is applicable will continue to grow, as China is actively negotiating free trade agreements with several trading partners.

- The **general tariff rate** is the highest tariff rate and it is applicable to imported goods whose place of origin is unknown.

- The **interim tariff rate** is applicable to selected imported goods and it is reviewed annually by the Tariff Committee under the State Council. An interim tariff rate is normally lower than a MFN tariff rate, ranging from 0% to 40%.

Tariff rate quotas (TRQs), or two-stage tariffs, are also in place in China for certain goods, including some agricultural commodities such as wheat, corn, rice and sugar. TRQs grant a lower tariff rate for importers of these products, until a certain quantity of total goods has been received. Once this predetermined benchmark has been reached, the tariff rate increases for all further imports of that product (Canadian Trade Commissioner Service, 2014).

Complex inspection regulations apply to certain goods imported into China, requiring products to arrive with certification from an international entity approved by the Chinese government, or further inspection and testing by Chinese officials upon arrival. For agricultural goods, it may be necessary for the manufacturing facility to be certified by Chinese inspectors at a site visit, prior to the product's entry being approved, as Chinese standards take precedence over foreign ones if equivalency cannot be assured. Furthermore, a variety of labelling and packaging requirements are applied to imports of consumer goods (Canadian Trade Commissioner Service, 2014; International Market Advisor, 2014). It is highly recommended that Canadian producers consult an in-country Trade Commissioner for assistance with regard to their particular product and the relevant Chinese import requirements. More information can be found at the following site:

- http://www.tradecommissioner.gc.ca/eng/offices-china.jsp

MARKET CHALLENGES

- The Chinese market is enormous and expanding, but economic growth has slowed in recent years, and this trend is expected to continue in the near term.
- Lengthy procedural delays will be encountered at most stages of starting a new business, particularly with regard to obtaining construction permits.
- Many industries in China are already over capacity, with very high levels of fragmentation and limited opportunity to sustain a viable market share. In many cases, local operators also receive government subsidies, giving them a competitive advantage over foreign entrants that cannot clearly differentiate themselves (Witt, 2013).
- Economic advancement, market infrastructure, and consumer preferences vary greatly by region.
- Local partners can provide invaluable advice in terms of cultural preferences, regional trends, as well as complicated regulatory and legal processes and are essentially a necessity for doing business in China. However, due diligence is required in choosing who to trust as a local representative of your business which can be time-consuming, and the additional cost of their services must be taken into account.
- Proper etiquette is a key element of all business transactions. The level of attention one gives to honouring custom practices holds the power to make or break a deal.
- Inspection and certification processes for imported goods are complex and strictly enforced, with Chinese standards taking precedence over foreign ones. Taking the time to ensure compliance may incur extra time delays, but so will getting held up at the border.

MARKET OPPORTUNITIES

- China is the third-largest importer (when considering the EU 28 as a single market) of agri-food and seafood products in the world, and Canada is already the country's fourth-largest supplier.
- Disposable incomes are on the rise, and a large percentage of savvy Chinese consumers are looking for high-quality goods and luxury items, particularly those of a Western nature or from internationally recognized brands.
- Health scares, such as the melamine scandal, have driven increasing interest in foreign products.
- The country is working to shift from an investment-based to a consumption-based economy, creating opportunities for foreign companies to further supply this growing need.
- Sales in the retail sector are expected to double from 2012 to 2018, and the online format is seeing unprecedented growth.
- Many of the steps required to start a business are less expensive in China than OECD or other comparable countries.
- Second- and third-tier cities are offering new and less-saturated opportunities to enter the market.

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Agriculture and Agri-Food Canada, Global Analysis Division
1341 Baseline Road, Tower 5, 4th floor
Ottawa, ON
Canada K1A 0C5
E-mail: infoservice@agr.gc.ca

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