

# Coffee retail market hots up

Local brand Luckin springs up across China with digital-only payment model, brewing fresh competition for Starbucks

By **ROBERT BLAIN** in Melbourne  
For *China Daily Asia Weekly*

China is one of the world's most competitive markets. Companies and entrepreneurs might argue it is only for the most battle-hardened, because any profitable business idea tends to see competitors spring up very quickly.

This is what makes the unbridled success of American coffee shop chain Starbucks all the more puzzling. Since opening its first China outlet in January 1999, there has been no significant rival to Starbucks, allowing the Seattle-based company a clear run at capturing the market.

But China's retail coffee sector is hotting up.

According to Euromoney International data cited in media reports earlier this year, Starbucks held 58.6 percent market share in China, followed by McCafe (part of the McDonald's fast food franchise), sitting a distant second at 6.1 percent. The total coffee shop market in China in 2017 was estimated to be worth \$4.5 billion — and set to grow as China embraces a coffee culture.

Starbucks' official website reports that it currently has 3,400 coffee shops in more than 140 Chinese cities.

"The one thing that defines Chinese consumer markets is ferocious competition. Didi versus Uber, bicycle sharing ... and then there's Starbucks cruising along with store after store. They're all very profitable and nobody's (been) taking them on," Jeffrey Towson, a professor of investment at Peking University Guanghua School of Management, told *China Daily Asia Weekly*.

Until now. With the arrival of Beijing-based Luckin Coffee in 2017, the landscape for cafe culture in China has changed markedly, with Luckin serving up a serious challenge to Starbucks.

News portal Quartz reported that as of July, 525 of Luckin's distinctive blue-and-white stores — with the striking deer logo — had opened in China in less than nine months. It is likely the number of stores has grown significantly since then.

"Starbucks leads with their high-visibility, high-traffic locations — that's their thing. Luckin leads with digital. You order on your phone. Luckin is more grab and go — a more streamlined process," said Towson.

It is not Luckin's bricks-and-mortar presence that poses the biggest



Customers buy coffee at a Luckin Coffee outlet in Shanghai on Aug 21. China's cafe culture landscape has changed markedly, with Luckin serving up a serious challenge to Starbucks. IMAGINECHINA

threat to Starbucks' Chinese operations — it is the strength of its digital delivery system.

"Starbucks and Luckin are targeting different markets to some extent, but there is a lot of overlap as well. The big difference is that Luckin is focused primarily on online ordering and delivery, and as this is a relatively new concept, it has to educate consumers on the benefits, get them to try out the service, and hope to retain them based on the convenience and value," said Pete Read, founder and CEO of strategic research and advisory firm Global Growth Markets.

Luckin's modus operandi revolves around the smartphone. When a customer enters one of its stores, to place an order they are immediately asked to download — if they have not already — Luckin's coffee-ordering app. Payment by cash is not an option. Customers can use WeChat payments or Luckin's own so-called coffee wallet.

"Cashless is the way to go. It improves cash flow, reduces losses

from human error, and is less time-consuming for staff. Luckin is betting that their customers are primarily in the segments that can pay digitally, and they might just be right," Read told *China Daily Asia Weekly*.

"But the digital-only payment trend has not yet spread into all 'new retail' ventures. Large sections of the population still prefer cash, especially outside the first-tier cities, where most people live."

Towson pointed out that there have been some minor competitors to Starbucks in China — milk tea stalls have been popular — but no one else offers "a premium retail coffee experience".

"Starbucks coffee (in China) is the same price as in New York and London. They've priced themselves at the top of the market. They are a luxury brand. The CEO (Kevin Johnson) has said their most profitable stores in the world are in China."

Typically, a cup of coffee at a Starbucks in Beijing costs around 35 yuan (\$5), whereas Luckin's is priced at around 25 yuan per cup.

rental contracts that prevent property owners from leasing to another coffee brand, the *South China Morning Post* reported.

Legal issues aside, Luckin is already using a number of clever marketing ploys to draw market share from Starbucks.

"Luckin will succeed in building market share through its many rapidly opened outlets and heavy discounting strategy. The real questions, though, are whether it can retain those customers as prices are pushed back up, and how long investors will be willing to subsidize the model before starting to look for a return," said Read from Global Growth Markets.

According to Towson, "What Luckin did was, they had a new strategy which was one of lower pricing, locations everywhere, and lead with digital. That could play out in two ways. One: they could offer the Starbucks experience at mass-market prices.

"The second idea is they can beat Starbucks another way. Starbucks is strong in real estate but they're weak in digital and weak in delivery, so let's be digital first. So Luckin won't win by having better real estate but by having a tighter hold on people's smartphones," said Towson.

Of course, a company with the brand power of Starbucks is not going to rest on its laurels while the challengers gather. Starbucks has just partnered with Alibaba, striking back at rivals and allowing it to boost both its digital and delivery credentials.

"The first thing that happened with this deal was Starbucks started delivery with one of the Alibaba companies. So now the Starbucks app has a delivery function. So you're not going to beat them on that anymore," said Towson.

Alibaba's delivery division ele.me has joined forces with Starbucks to deliver coffee and food to Chinese consumers. Initially it will be rolled out in Beijing and Shanghai but is slated to expand significantly by the end of 2018.

Towson said that the best move Luckin could make in response would be to gain a presence with consumers on WeChat.

In early September, this became a distinct possibility when Tencent — owner of WeChat — announced it was partnering with Luckin Coffee, creating yet another twist in China's fluid retail coffee sector.

"If you're embedded within WeChat, that's pretty amazing," said Towson.