

# Business Operation Model Analysis and optimization Path Research of Coffee Industry in China--Taking Starbucks and Rising as examples

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**Abstract.** Starbucks has been up against intense competition in the coffee business ever since Luckin Coffee, a quickly expanding coffee chain throughout China, entered the market. Luckin has quickly overtaken Starbucks, a premium brand in China, as a bargain competitor thanks to its speedy online ordering capabilities, prompt delivery, and readiness to offer discounts when shopping. Starbucks possesses, however, delicate decorated offline chain stores, which give customers a so-called loving and warming “third place” to work or study and offers many customized options to make clients’ favorite drinks. These components in Starbucks are something that Luckin cannot give to the crowd. People’s demands have been changing rapidly, so these companies need new strategies to adapt these adjustments to occupy a larger market share. This paper analyzes the business operation models and compares financial statements where necessary of these two companies to find the most optimum market strategies in the coffee industry, especially in China.

**Keywords:** Luckin; Starbucks; Business operation model; Optimum market strategies; China.

## 1. Introduction

### 1.1 Research background

Especially among office workers, Luckin is trying to work quickly to establish coffee consumption a habit in China. In order to compete with clients who choose the grab-and-go, high-efficiency business style and conveniences of quick delivery, its rapid proliferation led its international opponent, Starbucks, to cooperate with Alibaba on a delivery option. Additionally, Luckin frequently uses sales promotions on its items, which no rival has yet to match. On the other side, Starbucks Corporation is a well-known leading roaster, distributor, and seller of specialty coffee. It is an American business started in 1971 in Seattle, Washington. More than 20 years later, Starbucks still dominates the Chinese coffee industry with 4,447 locations across more than 200 cities, based on its Q3 FY20 report [2]. China is one of Starbucks' main coffee economies, providing 11.3% of the company's total revenues in the fourth quarter of the 2019 fiscal year [1].

Starbucks offers personalized services and promotes a welcoming and warm sphere where everyone can feel at home. It is worthwhile to research this topic since the pandemic crushes most of the stores in China. Producers should know what to expect from a successful operated company and what customers are asking for.

### 1.2 Literature review

Hatton discovered that careful shop placement, an upscale in-store experience, and commercial alliances with e-commerce providers had allowed it to develop a devoted following of customers, a potent offline and online brand presence, and a distinctive customer appeal [3]. From the traditional coffee market perspective, Luckin subtly solves the pain point and promises high-cost performance, thus effectively maximizing customers’ satisfaction. Furthermore, as according Qiu, Luckin's innovative strategies, including its generous discounts, online and offline sales, and efficient take-out system, not only attract new customers but also encourage existing ones to prioritize repurchasing its goods [4]. Yang further claims that Luckin developed the miracle of the retail business mode of coffee by examining the emerging marketing mode in the context of Luckin's operating strategy, competition, SWOT analysis, and other factors [5]. What’s more, as Luo wrote: Luckin Coffee needs to pay more

attention to long-term benefits and compete with Starbucks to ensure profits. If it cannot improve investor returns in the future, it won't be easy to conduct further financing or expand the market [6].

Most research has been done to analyze the focused strategies in Starbucks or Luckin, which they had done to survive. In contrast, there is little research paper concentrated on comparing the 2 companies' value proposition and financial data, making a final suggestion that can contribute to the current firms in the coffee industry.

### 1.3 Research framework

Eventually, this paper will discuss the appropriate suggestion for the current coffee company in China by first analyzing the business model. Then, analyzing the annual reports of Luckin and Starbucks so that it is clearer to see the overall effect of how the different market strategies have done on one's financial statement.

## 2. Research method: Comparative Analysis Method

A form of analysis called comparative analysis examines two or more things or objects to determine their similarities and differences. This paper will compare Starbucks' and Luckin's annual financial report data regarding their different value propositions and business models and judge which focused market strategies will offer more economic benefits while meeting customers' expectations.

## 3. Results

### 3.1 Development of the Global Coffee market

The market for coffee was estimated to be worth USD 102.02 billion in 2020, and it is anticipated to grow at a CAGR of 4.28% from 2021 to 2026. The COVID-19 dilemma is currently affecting the major coffee importing and consuming markets in Europe, North America, and Asia [7]. Instant coffee is still the most popular type of coffee in China, but the finely roasted coffee market saw substantial development in 2018, growing by 37% [8]. Also, retailers for coffee brands need to maintain attractive and high-quality coffee products, which are the key factors that can make customers come back next time [9].

### 3.2 Analysis of Coffee brands: Luckin and Starbuck

In the past few years, Luckin's scandal falsely inflated its sales by over 300 million dollars, resulting in debt and equity investors suing the company for fraud. In July 2020, Nasdaq officials banished Luckin from the U.S. exchange [10]. The company started its new value propositions, which successfully brought Luckin back from bankruptcy and returned to the Chinese market within 2 years. In the last year, Luckin narrowed losses to 86 million dollars, down from 406 million dollars in 2020, while revenues soared 80% compared to the previous year [10].

**Table 1.** Luckin Coffee Inc. Announces Unaudited First Quarter 2022 Financial Results [11]

	2021	2022	2022
	RMB	RMB	US\$
Net revenues:			
Revenues from product sales	1,106,832	1,855,297	292,666
Revenues from partnership stores	161,871	549,301	86,650
Total net revenues	1,268,703	2,404,598	379,316
	2021	2022	2022

The total net revenues in the first quarter were 2,404.6 million RMB, representing an increase of 89.5% from 1,268.7 million RMB in the same quarter of 2021. By the conclusion of the fourth quarter of 2021, there will be 6,580 stores, representing an increase in store units of 9.2% from the number of stores at the end of the previous quarter. In comparison to a net loss of 232.5 million RMB in the corresponding quarter of 2021, the company employed Non-GAAP methods to demonstrate a net income of 19.8 million RMB in the first quarter of 2022. Additionally, the first quarter of 2022 had a net income of 99.1 million RMB as opposed to a net loss of 176 million RMB in the corresponding period of 2021. This means with the current new value proposition, Luckin is doing better and is projected to have a profit in the future.

**Table 2.** Starbucks Reports Q1 Fiscal 2022 Results [13]

Quarter ended	As a % of international total net revenues				
	2-Jan-22	27-Dec-20	% change	2-Jan-22	27-Dec-20
Net revenues:					
	RMB	RMB	US\$		
Company-operated stores	\$1,508.30	\$1,441.70	4.60%	80.40%	85.70%
Licensed stores	334.9	225.2	48.7	17.9	13.4
Other	32.7	15	118	1.7	0.9
<b>Total net revenues</b>	<b>1,875.90</b>	<b>1,681.90</b>	<b>11.5</b>	<b>100</b>	<b>100</b>
Product and distribution costs	615.8	536	14.9	32.8	31.9
Store operating expenses	697.6	628.5	11	37.2	37.4
Other operating expenses	39.2	35.6	10.1	2.1	2.1
Depreciation and amortization expenses	133.1	140	-4.9	7.1	8.3
General and administrative expenses	91.3	85.1	7.3	4.9	5.1
Total operating expenses	1577	1425.2	10.7	84.1	84.7
Income from equity investees	0.7	26.3	-97.3	-	1.6
<b>Operating income</b>	<b>\$299.60</b>	<b>\$283</b>	<b>5.90%</b>	<b>16.00%</b>	<b>16.80%</b>

While one of the most popular coffee shops in China is Starbucks, the Financial Times reports that in 2018, Starbucks contributed 50% of China's speciality coffee market revenue. Luckin only received 2.1 percent of the total revenue, in contrast [12]. This is because it can command a greater price for its coffee thanks to the value of its brand, particularly in China, as buyers there believe that foreign brands are of superior quality [12]. The annual chart provides the information on net revenues for the international licensed stores of 1875.9 million dollars on January 02, 2022, which was 12% higher than December 27, 2020 [13]. The increase in operating income or the net revenue was primarily driven by the increasing number of licensed stores Internationally, as the expenses had also increased. Overall, the financial performance of Starbucks has been stable throughout the year, and I consider this is due to people's exclusive brand loyalty and the attractive "Starbucks experience".

Contrastingly, Luckin does not provide clients with the high-end experience of spending an afternoon sipping coffee in a coffee shop due to its "take-and-go" approach and delivery focus. A "third location" between home and work that served as a public meeting room or a tranquil haven from the hectic outside world is how Starbucks established its business in China at the same time.

Additionally, typical Starbucks cafés can serve as pick-up locations, but the opposite is not true. As of March 31, 2018, Luckin has just 86 "relax shops" in China, giving Starbucks the advantage in this regard [12]. However, Luckin's pick-up shops are thoughtfully positioned in busy business and office districts, where there is a significant demand for coffee [12]. Then people there may prefer to have a quick cup of coffee taken to work rather than sitting in the store the whole afternoon [12]. Additionally, Starbucks had been copying Luckin's marketing techniques. For instance, Luckin was the one who first recognized the importance of delivery services to China's modern economy. However, Starbucks quickly entered the delivery market by announcing a partnership with Alibaba's delivery platform Eleme in August 2018 in order to counter Luckin and keep its market share in this sector [12].

### **3.3 Current marketing crisis of the coffee industry**

Overcoming the pandemic damage is a critical hurdle for every coffee producer, and it is paramount to realize the consumers' trends in tastes. According to Elliot, consumers prefer cheaper and safer homemade coffee [14]. This is not only because of the people's concern of financial crisis and outrageous living cost increases but also the social distancing policy that limits people's choices. However, it is obvious that before COVID, out-of-home coffee is the main access of revenue for a company. The perfect daily grind estimates that this type of coffee accounts for about 25% of overall consumer demand [15]. As a result, changing the selling technique is crucial because the current situation forces more individuals to stay at home. Additionally, between 2008 and 2016, the demand for speciality coffee beverages rose sharply among consumers aged 18 to 24 (13% to 36%) and among those aged 25 to 39 (19% to 41%), demonstrating the importance of millennials' taste preferences in the evolving coffee industry [16]. In this way, in order to overcome the quarantine obstacles, producers ought to know the evolving preferences among millennials, as their consumption occupies the biggest amount among all ages of people. Additionally, a significant change in how quality coffee is traditionally brewed has been made by a growing number of individuals. A recent influx of books or tutors on social media has made it easier to enjoy high-quality coffee at home [17]. It is reasonable to conclude that physical stores' sales will decrease, which is also the upcoming problem that needs to be overcome by the coffee industry.

## **4. Discussion**

Luckin's entrepreneurs have a great vision, spot great opportunities in China's market, and create innovative ideas, which the big coffee company, Starbucks, would even copy. Both companies' value propositions make them a big success in the coffee industry. Plus, there's one extra new strategy the coffee company should consider.

### **4.1 Conveniency-Online service and quick delivery**

With the sudden outbreak of COVID, more and more stores had been offering services conducted online. This is because gaining online access might seem to be the only way retailers can still sell things out, and it might be deemed a bit compulsory and obligatory. Luckin's entrepreneurs spotted this need in advance. With significant discounts and online sales, they claimed that it introduces consumers to a novel coffee concept and creates a breakthrough for the entire coffee market. The instant take-out system is effective [4]. Luckin takes Internet coffee as its orientation, makes full use of the influence of the media to forge a new coffee marketing model, and adds the current delivery system that brings great convenience to the public into the coffee model. Hence, it has quickly become outstanding in the fiercely competitive coffee market, thanks to this creative approach [18]. Starbucks also reckons this to be important due to the transmission of the market and the concern of losing customers in China

## **4.2 Intimacy- Cozy environment and customized services**

Intimacy can be shown in a cozy environment and customized drinking options. This is the value proposition taken by Starbucks, and it appears to benefit the company as it earns customers exclusive brand royalty. On the one hand, thanks to its warming and loving atmosphere with chairs and desks where business people or students spend their time working, more and more people believe Starbucks is selling more than just its coffee but also space where people can share and communicate. On the other hand, Starbucks offers personalized options for designing the most favorable drinks for their customers, which Luckin has not been able to perform in the same way. Therefore, Starbucks, with more and more drink options, targets more people and will require a bigger scale of the market. Providing more and more drinks selection may be the main mission, but coming up with secret ingredients that could make one drink seems unique and apart from others should be paramount. Hence, sales will increase as consumers get these particular drinks in one place.

## **4.3 Sensitivity- flexible when the market is changing**

Being sensitive means, the coffee firms should be flexible when the market is changing and when the enemy's decision or the consumer's taste is evolving. First, the company should be alert and responsive to any spillovers, which means the firm should detect other substitutes' development while protecting their own intellectual property. In this case, investigating others through econometric studies to assess how a rise in innovation in one firm affects performance in another may benefit itself's business. Starbucks, for instance, is a huge beneficiary of spillover effects by adopting Luckin's online selling market mode. In addition, more and more individuals love the new and loathe the old from time to time. Therefore, the company should pay more attention and be ready to make innovations on new drinks, cups, or bags to maintain their customer base. Firms must be flexible. Since an increasing number of people choose to make homemade specialty coffee on their own, firms can offer the products that can help consumers make delicious drinks at home. For instance, Customers can buy Starbucks' coffee beans and equipment. Three-quarters of American consumers increasingly make coffee at home using manual brewing methods rather than instant coffee or simple filter coffee makers, according to a Sprudge poll [17]. Additionally, 41% of those who drink coffee at home use a drip machine [19]. As handmade coffee has become a privilege, this proposition may thus be profitable.

## **4.4 Three trends in China's coffee industry**

### **4.4.1 The "third space" of coffee consumption will be weakened**

Self-pick-up and take-out have recently emerged as a new trend for consumers to buy coffee as a result of the ongoing development and maturity of the take-out and Internet industries. This has quietly changed the consumption habits of domestic and foreign consumers regarding catering and even coffee. A new retail concept of online order and offline self-pick was launched by the recently established Luckin Coffee towards the end of 2017. Zhuan Star Delivery, a Starbucks food delivery service, was formally introduced in China in September 2018. That same year, in October, McCafe also introduced a delivery service. Starbucks' "Quick Coffee" service, which enables online orders to be placed and picked up in shops, was also introduced in China in May 2019. Consumers of coffee will increasingly favor online consumption in the future.

### **4.4.2 Unmanned retail may become the new normal of coffee consumption**

Intelligent unmanned terminals are more flexible, less expensive, and not location-restricted than retailers. Because of this, unmanned retail is common in China. After Luckin formally unveiled its "unmanned retail strategy," which fully exploited China's new Internet infrastructure to push the unmanned retail sector to upgrade once again, this occurred. Unmanned retail may become the new norm for coffee consumption, thanks to Luckin Coffee.

#### 4.4.3 The taste and form of coffee products are gradually diversified

Young individuals who are willing to try new things are currently the key driving force behind China's coffee consumption. A single cup of coffee therefore won't suffice to satisfy their long-term needs. To consistently "stimulate" consumers' urge to buy, coffee firms must innovate, introduce the new, and excel at producing coffee goods with distinctive selling qualities. It is anticipated that there will be an increasing variety of coffee goods as the Chinese coffee market continues to expand.

### 5. Conclusion

To conclude, the recent coffee industry is struggling with the attack pandemic, and the entrepreneurs in this industry miserably to adopt to save prospects. By taking Starbucks and Luckin as 2 comparable large-large-scale coffee firms, the data shows the importance of different value propositions that may bring different market performances. Luckin pursues and targets its consumers whose work needs instant specialty coffee. At the same time, Starbucks prefers to provide a delicate cafe house for all the customers to relax and save as an information-sharing space for business and any other means. This paper analyzes the recent crisis in the coffee market and realizes the positives that 2 companies' value propositions offer to lead to discussions that provide implications and tackling strategies for the recent change of coffee not only in the perspectives of consumers but also in favor of producers. First, convenience can solve the problem caused by social distancing policy so that people could get a cup of coffee while in quarantine or work at home. Second, an Intimate service, such as personalized drinks and a warm cafe atmosphere, may increase the brand effect and increase the returned consumers as much as possible. Finally, being alert to its enemies may increase its brand security, but it also needs to keep track of what the competitors have in mind to maintain the consumer base. Furthermore, companies should be more aware of the increasing demand for homemade coffee so that they can ensure sustainable growth in their revenue.

However, limitations are inevitable. This paper uses international annual reports and only talks about how coffee companies function in China. Admittedly, it is hard to find authoritative financial analysis data exclusive to China. Moreover, there has not been much data for 2022, and evidence 16 is too old. There might be concerns that the actual situation would not be the same right now. Finally, the author only discusses the reasonable strategies one coffee company might adopt during the discussion. Still, there's no analysis on these strategies or whether they will provide short turn benefits and long turn threats. The projection isn't made as it is too vague, and there's little evidence that has been found that can prove the feasibility of strategies.

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