

The strategy and financial analysis of Luckin Coffee

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Abstract: Luckin breaks through the traditional mode and creates the miracle of the new retail mode of coffee. We analyze this new retail mode from different aspects: Luckin's operating strategy, competitor, SWOT analysis and so on, and we also give some suggestions that can help Luckin deal with some potential problems and seize the opportunity.

Keywords: "New Retail" Marketing Concept; Luckin Coffee; Strategy

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1. Overview

1.1 About Luckin Coffee

Luckin Coffee has been rising in China in the past two years. It mainly sells coffee, including Master Coffee, Zero Latte, Rena Ice and Classic drinks. It also sells snacks, which are divided into fresh salads and healthy light foods. As Luckin Coffee enters the international market, it has become a symbol of globalization, showing China's coffee brand.

1.2 Financial Ratio Analysis

According to public information, since the financing of tens of millions in April 2018, Luckin Coffee has won three rounds of financing totaling USD 550 million in July 2018, December 2018, and April 2019. In the first quarter of 2019, Luckin Coffee received about 4.461 billion yuan through financing. On the evening of May 17, Luckin Coffee (LK) officially landed on Nasdaq. According to the prospectus, Luckin Coffee provided 33 million American Depositary Shares (ADS), and 8 American Depositary Shares per Share of class A common stock, a total of 695 million US dollars of funds raised.

From previous prospectus disclosure, its revenue

in 2018 was approximately 840.7 million yuan (about 125 million US dollars), and the net loss was 1.619 billion yuan. In Q1 2019, Luckin's operating income was 485 million yuan (about 71.3 million US dollars), and the net loss was 551.8 million yuan. Its net loss rate has narrowed, decreasing from 966% in the first quarter of 2018 to 115.3%.

In terms of the cost, the scale of Luckin's cost has gradually decreased, and the marketing expenses mentioned in the prospectus are gradually decreasing. In the first quarter of 2019, the cost was reduced from 103.5 yuan to 16.9 yuan, a drop of 84%, in the previous two quarters the cost was 25 yuan and 51.6 yuan. This can at least show that after more than a year of marketing, Luckin coffee has formed a relatively considerable market share and earned certain brand recognition.

From the data, Luckin's beverage sales in proportion to operating income revenue decreased, from 86% in 2017 to about 75%. While the corresponding income of other products such as light food increased from 10% to 17%. To a certain extent, this shows that as SKUs continue to increase, their operating income

is no longer solely dependent on coffee sales, becoming more and more diversified.

Table 1. Income Statement Currency in CNY.

All numbers in thousands

Revenue	12/31/2018	12/31/2017
Total Revenue	840,695	500
Cost of Revenue	532,217	1,578
Gross Profit	308,478	-1,078
Operating Expenses		
Research Development	-	-
Selling General and Administrative	1,702,000	98,056
Non Recurring	-	-
Others	-	-
Total Operating Expenses	2,438,701	112,914
Operating Income or Loss	-1,598,006	-112,414
Income from Continuing Operations		
Total Other Income/Expenses Net	-21,146	-328
Earnings Before Interest and Taxes	-1,598,006	-112,414
Interest Expense	-16,121	-16,121
Income Before Tax	-1,619,152	-112,742
Income Tax Expense	-	-
Minority Interest	-	-
Net Income From Continuing Ops	-1,619,152	-112,742
Non-recurring Events		
Discontinued Operations	-	-
Extraordinary Items	-	-
Effect Of Accounting Changes	-	-
Other Items	-	-
Net Income		
Net Income	-1,619,152	-112,742
Preferred Stock And Other Adjustments	-	-
Net Income Applicable To Common Shares	-3,190,334	-112,742

1.3 Future

It is expected that by 2025, China will become a major coffee consumer in the trillion-dollar market. According to the founder Qian Zhiya, the company has ample cash, with about 2 billion yuan in cash, and plans to expand the number of stores to 4,500 in 2019. After the Internet comes into the coffee industry, the entire market enters into a new stage, and the Chinese mass coffee market will be more mature.

According to the data, China's coffee sales are expected to increase significantly in the next few years. According to the prediction of Luckin Coffee in the 2019 China Coffee Market Development Data Report, if Luckin can reach 440 million cups of coffee in 2019, it can be compared with the current annual sales of 400 million cups of Starbucks. In 2021 it will achieve profitability, with a net profit, which can use the PE value (28-50) to make a valuation forecast and it will have a relatively complete and probable valuation variable range of \$1.9 billion - \$46.2 billion

After listing in Nasdaq, Luckin Coffee has certain advantages in terms of the upgrading of China's consumer market and the concept of mobile Internet. It may expand the market through the capital advantage after the issuing, reducing the cost and expand the income through the scale advantage. Experts believe that from the perspective of capital, industry, and consumption, Luckin's profit model, operating model, and sustainable development ability are still very promising.

2. Operating strategy

2.1 Adopting the “new retail” marketing concept

The concept of “new retail” was originally proposed by Jack Ma: “The traditional retail industry that does not adopt technology, data, innovation has no future. In the next ten or even twenty years, only by combining online, offline and logistics to create a ‘new retail’ model, can companies survive.”^[1]

Traditional retail models always tend to be independent of online, offline and mobile channels, while the “new retail” model differs in that it built and integrated multiple channels in the marketing process. Its main features are: (1) the in-depth combination of “online + offline + logistics,” aiming to provide consumers with omnichannel and all-round services; (2) optimizing retail efficiency based on big data and cloud computing; (3) advocating customer first, meet the maximum needs of consumers through data analysis^[2]. Luckin achieved better shopping convenience value through “new retail.”

2.2 Product and brand packaging strategy

A good product is the starting point for all business models. By hiring a more professional barista, using excellent raw materials, and equipping better coffee machines, Luckin Coffee provides users with a mellow and stable quality coffee.

Brand color: a large area of pure blue. It has a strong impact on the naked eye and can quickly form an eye-catching visual tool.

Brand symbol: the antler logo full of tension, the exaggeration and vitality of the antlers also subtly convey the brand tone of “professional fresh fashion.”

Brand spokesperson: Tang Wei, Zhang Zhen of the literary label. They correspond to Luckin coffee's new workplace, making the coffee brand appear more advanced.

2.3 Pricing Strategy

Luckin Coffee adopts the strategy that users who download APP and register for the first time may get a cup of coffee for free. What is more, they can buy one for one 50% off, send a 82% discount coupons or other forms of subsidies to attract users to register and make orders. After registration and purchase, they will also receive various messages to stimulate their repeated purchases.

2.4 Marketing Strategy

2.4.1 Pull new in social activities

Most of the advertising fees of Luckin are in the form of giving subsidies to users. What's more, they use various interesting ways to inspire regular customers to obtain new customers. On the day of the official launch of the new gift on January 5, 2018, the number of new user registrations doubled from the previous month, and orders increased by 40%.^[3]

2.4.2 Advertising

The slogan "This cup, who doesn't love" pushes the Little Blue Cup to the public. Luckin positioned itself as a master of coffee, emphasizing the use of the finest Arabica beans in the advertisement, using advanced coffee machines and supporting equipment, and hiring the winner team in WBC World Barista Competition to match, guaranteeing the taste quality. It also makes advertisements in the Focus Elevator, media platforms, and the major theaters. The company has entered the consumer's field of vision with lightning speed. At the same time, through the advertisement in WeChat moments, brand awareness has been rapidly improved.

2.5 Cost Strategy

Using a strategic loss strategy, Luckin had a deficit of RMB 857 million in the first nine months of 2018, which surprised the outside world. In addition, Luckin used the model of large-scale subsidy to get customers. Even if it was questioned, the person in charge said that this is a strategic loss and will not stop subsidies.

It also emphasizes that Luckin Coffee will not become the next ofo, which endured its bankrupt in the past few months.

3. Competitor

3.1 Basic Information

Founded in 1971, Starbucks has nearly 20 years of brand influence in China and is unique in the coffee industry, establishing a leading position in the premium coffee industry. Its aggressive, elegant fashion and brand image with humanistic spirit are widely recognized and welcomed by consumers.^[4]

3.2 Customer Orientation

It is not an ordinary public, but a group of urban white-collar workers who focus on leisure and petty bourgeoisie life. In large and medium-sized cities, Starbucks has become a symbol of the identity of young fashion in white-collar workers. The consumer tonality established by Starbucks links vanity, sentiment, business negotiation, culture and other factors to coffee, allowing more users to start to contact coffee and cultivate consumption habits.^[5]

3.3 Compare Operating Strategy

“Do not spend a penny to advertise” is Starbucks' consistent claim. However, in the face of the “new retail” model of the coffee industry, the traditional retail giant Starbucks could no longer sit still and reformed its marketing model, while Luckin Coffee putting forward the “infinite scene” strategy. Different stores are opened for different scenes, and the office life scenes are deeply embedded in four types of stores, such as ELTIE flagship store, RELAX store, PICKUP cache store, and KITCHEN takeaway kitchen store. You can sit in the store and enjoy coffee, or you can choose to order online and wait for the delivery. The innovation of this concept is to let coffee find people, instead of the people to find coffee. On the other hand, from the perspective of physical space, the cost of operations can also be greatly reduced.

In order to create a comprehensive and integrated consumer experience in accordance with local conditions, Starbucks formed deep strategic cooperation with Alibaba in August this year. After Luckin Coffee launched the delivery service, Starbucks also followed suit. Together with the delivery APP, it created a take-away mode of coffee and snacks, which will create a “star segment” within a 3 km diameter of nearly 2,000 stores in 30 cities in China.^[6]

4. SWOT analysis

4.1 Strengths

4.1.1 New retail model and gridded layout make customers purchase easier

The new retail thinking is Luckin's most fundamental innovation. The core value is online customer efficiency and comprehensive operational efficiency. Most of the users have already ordered before they arrive at the store. They just come to the store to take away coffee or sit for a while. From this point of view, the future will have the advantage of unlimited efficiency optimization space.^[7]

4.1.2 Saving a lot of costs

Luckin is a self-service store, completely different from Starbucks' third space, social and service experience. This method saves a lot of service costs, including the cost of the cash register system, the cost of the cashier training for the waiter and so on.

4.1.3 Cheaper price

Luckin frequently does the activities of making discounts and its original price is half of the Starbucks's. This way attracts a larger number of customers and achieves small profits but quick turnover.

4.2 Weaknesses

The taste of it is not good, according to some customers. Since the management training of store staff is not in place, the taste of coffee is at the lower level, such as hot chocolate which tastes like water. In addition, compared with peers, Luckin has too few new products every season and did not form their own special products. The variety is relatively single, and the choice is limited.

The discounts cannot be delivered and it will be wasted if not used, so users will feel disappointed when losing the discount. Luckin mainly adopts a model of subsidizing customers such as discount coupons. However, after the subsidy, it is not easy to retain users and lacks a sustainable membership incentive system. There is an old saying in the O2O industry that users will come with subsidies and will go with subsidies. Users who are simply subsidized are not loyal.^[8]

4.3 Opportunities

With the acceleration of urbanization and the improvement of national income, China has become the world's most potential market for coffee. The reason why its founder invested Luckin's capital dares to take out a

lot of money to let it burn is that the founder foresaw this huge potential growth space.^[9] Therefore, under the capital blessing, it can become the fastest IPO company in China, setting a record speed for listing, and approaching the Starbucks which has been working hard in the size of the store for 20 years.

It is expected that the scale of China's coffee market will maintain a growth rate of 11% to 15% in the next few years, and the market size is expected to exceed 44 billion yuan by 2022.^[10] As long as this big cake can be divided into a considerable share, it is enough to support a huge strategic dream.

4.4 Threats

Although Luckin has attracted a lot of online traffic in less than one year since its establishment, user flows and user groups are still two completely different concepts. I have to admit that Luckin is hard to shake consumer recognition of Starbucks in the short term. The choice we make does not mean that we truly like it. Luckin Coffee claims to have 12.54 million users. However, it must understand that these 12.54 million users are different from each other. How many of them can be called true loyal fans? Are they mostly attracted by the first free offer and follow-up various promotional offers? This is a question that must be considered.

5. Suggestions

5.1 Accelerate the expansion of coverage

From the current point of view, Luckin's attack points are mainly concentrated in first- and second-tier cities. In just 10 months, the number of stores has exceeded 1,100, which is remarkable. However, this 1,100 stores are only located in 14 cities. While the strategic significance of stabilizing in large and medium-sized cities is self-evident, the plasticity of the third- and fourth-tier markets is stronger, for the simple reason that other brands have not yet entered or popularized in these cities. The coffee chain in the first-tier large and medium-sized cities has basically reached saturation, and the second and third-tier cities have entered the market with rapid environmental impact and rapid development. When Starbucks has not taken into account the huge volume of small and medium-sized cities, it will be an opportune moment for Luckin to take the first step to win the third- and fourth-tier cities with strong plasticity and to deploy one or two stores in its core business district.

5.2 Building its own brand culture

Comparing to Starbucks, whose coffee store emphasizes vertical regional cultural attributes from design to layout: not only delicate but also deeply integrated with local culture, which is one of the reasons why Starbucks is praised. Since Luckin advertises its high degree of Internet genes and white-collar characteristics, most of the stores are directly embedded in the office building. Hence it can be changed from another angle: emphasizing the horizontal professional attributes. For example, in the design and decoration of the store, it can emphasize the characteristic of efficient, clean, friendly, convenient and modern. Impacting the visual nerves of white-collar workers are in sharp contrast with the traditional conservatives of Starbucks, and this is in line with Luckin's own temperament, coinciding with Luckin's "infinite scene" strategy.

5.3 Creating incremental value

Luckin needs to create incremental value. Like some big fresh seafood shops, a lot of activities will be done in one year like parenting, cooking, etc., constantly updating the goods and content, so that users have a fresh sense of shopping and become a new local life center. Similarly, Luckin needs to cultivate its customer base, acquire new customers, and build a consumer mind. If it just makes it easier for customers to obtain coffee through the pop-up shops, it will not cultivate a new user group of coffee and lose a large number of poten-

tial customers. In sum, it is better for Luckin to create some incremental values.

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