

# ***Analysis of Luckin Coffee's Operating, Marketing and Expansion Strategies***

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**Abstract:** As the big data applications and online retail mode get increasingly involved in daily lives, differential marketing and operating strategies are continuously surfacing. With the exponential expansion, China's coffee industry is catching up to the average global consumption rate. More and more emerging companies are appearing in people's fields of vision in this cutthroat industry that is still far from being saturated. Luckin Coffee, the first Chinese coffee company, revolutionized the traditional coffee industry with its digital operations, big data planning, and fission marketing. This paper will focus on Luckin Coffee, a rising star in China's coffee market, by examining and analyzing the operating and marketing schemes that they implement under such big environments. By exploiting case analysis, comparative analysis, data analysis, and document analysis, the advancement of Luckin's operating and marketing strategies can be concluded, consisting of disparate positioning of offline coffee shops, mass implementation of fission marketing, alleviating time duration on delivery and self-pickup services, and innovation on taste and products by big data predictions.

**Keywords:** big data, fission marketing, financial fraud, coffee consumption

## **1. Introduction**

On May 24, 2022, Luckin Coffee (OTC: LKNCY) published its first quarter 2022 unaudited financial report. According to the data, the company's operating profit for the quarter turned positive for the first time and it reached overall profitability. The total net income for the first quarter was 2.4046 billion yuan, an increase of 89.5% over the same period last year. While merely a year ago, Luckin encountered its most severe threat ever to be delisted from Nasdaq. This paper will dig further into the fundamental logics of the operating and marketing strategies put forth by Luckin Coffee and discover the underlying rationale of mass expansion and how they regained trust from the financial market. Through case analysis, comparative analysis, data analysis, and document analysis, this paper will deliver an overall comprehensive image of the past, present, and future of the Chinese coffee market. To be more specific, this paper will acknowledge and illustrate the advantages and disadvantages that Luckin Coffee has enforced in its aggrandizing journey. Steps further, to thoroughly contemplate the strategies of Luckin Coffee, as one of the representative companies combining big data analytics with traditional retail models, one can also examine the feasibility of such a way of expansion, particularly in the Chinese market.

## 2. Luckin Coffee's Past and Financial Fraud

### 2.1. The Origin of Luckin Coffee

Luckin Coffee, one of the largest chain coffee brands in mainland China, was founded by Zhiya Qian in October 2017. With the goal of "creating lucky moments and inspiring aspirations for a better life," Luckin Coffee fully utilizes the new retail model based on mobile Internet and big data technology and works with top-quality suppliers in a variety of industries to produce a satisfactory coffee-related consumption experience [1].

### 2.2. The Staging of Luckin Coffee

Since its debut, Luckin Coffee has seized China's mid-to-low-end market with high-quality and affordable products, efficient and convenient services, and launched its differentiated competition with Starbucks. Luckin has invested significantly in large-scale expansion strategies since its founding, which has caused a substantial operating deficit on record. It has once proposed to expand its stores to 10,000 in 2021. Even after the impact of financial fraud, as of June 2021, the number of its domestic stores still reached 5,200. At an average rate of 623 new stores per quarter, the growth rate of new stores and the total number of locations outpaced Starbucks respectively [2].

### 2.3. The Financial Fraud of Luckin Coffee

**Inflated Operating and Marketing Cost.** In 2020, Muddy Waters, a short-selling agency, claimed that it had received an 89-page anonymous report which cited 6 warning signs, 5 business model faults, and 5 evidence of data fraud for Luckin Coffee.

Luckin Coffee declared its marketing expenditures until April 2019 in the prospectus. According to the anonymous report published by Muddy Waters, Luckin increased its advertising budget in the third quarter of 2019 by more than 150%, particularly on the cost of Focus Media, Luckin's primary advertiser. According to Luckin Coffee's financial report for the third quarter of 2019, the company spent about 382 million yuan on advertising. However, the click-through rate using CTR market research disclosed that the cost of Focus Media is merely over 46 million yuan as of the cost of their primary advertiser in the third quarter of 2019[3]. In this case, only 12% of its declared advertising expenses were represented by this sum. This charge alone had an inflated value of more than 300 million yuan. Coincidentally, the cost that Luckin Coffee exaggerated on advertising was fairly similar to its inflated operating income. The former was approximately 336 million yuan, while the second was about 397 million yuan. This raised the possibility that Luckin Coffee's management team may recoup the exaggerated advertising costs from sales.

**Inflated Operating Income.** Muddy Waters Research discovered that Luckin Coffee has blatantly inflated the pricing and sales volume of its products in the market according to the anonymous reporting reports along with investigations. A number of on-site store recordings with a combined runtime of 11,260 hours served as supporting documentation for the report. The findings revealed that Luckin Coffee overstated the daily sales volume of individual outlets in 2019 by at least 69% in the third quarter and even as much as 88% in the fourth quarter. The report asserted that in order to gather on-the-spot evidence from Luckin Coffee's offline locations over the course of 981 working days, which covered nearly all of the company's operation hours, they engaged a total of 1,510 personnel [3]. The anonymous whistleblower also gathered client receipts for his report and asserted that Luckin had overstated each item's net selling price by at least 1.23 yuan. The actual losses at the retail level could range from 24.7% to 28%. The selling price, excluding complimentary products, is approximately 46% of the quoted price rather than 55% that the management team has claimed [3].

### **3. Luckin Coffee's Operating and Marketing Analytics**

#### **3.1. Potential Market of Coffee Industry in China**

Public information indicates that the current worldwide market for coffee consumption has a turnover of roughly 12 trillion yuan, of which the US accounts for 3 trillion and China only 200 billion [4]. According to the average annual per capita consumption of coffee in the world's main nations, Finland consumes 12,000 grams while China only consumes 30 grams. The market for retail coffee products and coffee eaten in cafes has expanded significantly in China during the previous five to ten years, from 22 billion yuan in 2014 to 75 billion yuan in 2020. However, "in 2020, the per capita coffee consumption in China is 9.1 cups per year, which is significantly lower than that of South Korea (367.0 cups per year), the United States (327.4 cups per year), Japan (280.1 cups per year) and the global average (161.3 cups per year)" [5]. Such horizontal comparison implies that there is still a lot of room for the coffee market in China to expand. Additionally, as the average personal income among Chinese citizens continues to rise, it will eventually reflect on the consumption level in the coffee industry.

With the development in people's living conditions and acceptance of imported items in recent years, China's coffee consumption has been increasing steadily. Statistics demonstrate that "the average annual growth rate of coffee consumption in China is 15%, which is much higher than the growth rate of 2% in the world, and with every 5% increase in national income level, coffee consumption will increase by 2%-3%" [5]. Under such circumstances, the potential of the Chinese coffee industry is yet to be fully extracted.

#### **3.2. Current Pain Point in Coffee Consumption Industry**

Coffee is not widely consumed in China for two reasons, according to Qian Zhiya, the founder and CEO of Luckin Coffee: It is pricey. Currently, the average price for a cup of coffee in offline shops in China is 30 yuan, which is more expensive than prices for other drinks such as milk tea, fruit juice, carbonated drinks, etc. Moreover, despite the enormous coffee market in China, there aren't sufficient coffee shops there to fulfill the potential demand. There are fewer than 6,000 cafes in Shanghai, which has a population of 22.5 million people, and a professional coffee shop is often at least a 30-minute walk away [4]. The difficulty of buying freshly ground coffee has made it more difficult for the Chinese coffee market to increase its consumption level. However, as the middle-class white collars gradually take over the majority composition of populations in cities, the appeal to caffeine has grown accordingly. From the perspective of Qian, she didn't pick the coffee business at random. Rather, she has said in previous interviews that staying up late and working overtime have caused her to acquire a strong need for coffee, and Starbucks appears to be at a loss for options when it comes to the available coffee [4].

#### **3.3. Segmentation, Targeting, and Positioning**

With the use of the STP Strategy, marketers can pinpoint the market segments that they believe their business can serve more effectively than rivals while positioning their product lineup to appeal to those segments. Customers are divided into groups by occasion, geography, and demographics at Luckin Coffee. The marketing goal of Lukin Coffee is to make sure that its customers can easily and affordably purchase high-quality coffee. Through the combination of the geographic and demographic segmentation, Luckin can easily find that the coffee customer is mainly in Tier1 and Tier 2 cities, and are normally between 15- 35 years old [6]. Further, utilizing occasion segmentation, it was found that the majority of Chinese coffee buyers drink their coffee to feel refreshed and for its flavor. It turns out that the proportion of the need for social contact just accounts for 15% [6]. As a

result, they typically pack coffee rather than consume it there. As a result of these elements and the allure of the various sectors, Luckin decides that white-collar and student groups, which are recognizable, significant, and reachable, are its primary target market.

### **3.4. Positioning and Store Types of Luckin Coffee**

Luckin Coffee offers customers high-quality coffee that has been specially brewed to suit Chinese tastes as a result of its marketing objectives and target customer segmentation. It also offers tea beverages, such as milk tea, so that its sales range can reach young Chinese people who are not accustomed to coffee. As consumers pick up their drinks, it will also offer them light fare and dessert. The price of its product usually lies between 15-25 yuan, which is between instant coffee and Starbucks coffee. The majority of middle-class people are willing to get coffee in this price range. Regarding the issue of location, Luckin Coffee offers three different types of stores, 92% of which are self-pickup stores, in order to serve its customers with convenient coffee [7]. It is primarily found in places with significant demand for coffee, such as commercial centers and college campuses. It offers customers online ordering, a quick coffee manufacturing service, and the option to pick up their own drinks, which will take care of the majority of their daily drinking requirements. In 4% of the stores, there are kitchens where coffee is prepared and delivered to customers by couriers. A third venue for customers to socialize and rest is provided by the other 4% of offline establishments, similar to the Starbucks coffee stores that are opened in shopping malls [7].

### **3.5. Definition of Fission Marketing**

The goal of marketing is to attract new customers, and "fission" is at the heart of social media marketing. The goal of fission marketing is to harness everyone's social connections to increase influence and spur growth. Advertising subsidized marketing was used to carry out advertising marketing for stores. Fission advertising marketing major is a type of only in the condition of known consumers, stores advertisement cost directly into consumer products and benefits so that consumers get more profits and flow, improve consumer acceptance of the brand [8]. This is in contrast to store advertising directly paid to advertising companies but the actual effect is the consumer of the unknown. Additionally, offline retail outlets are rapidly expanding as a marketing strategy. In addition, Luckin wants to "make everyone have access to a cup of decent coffee" and develop goods that are reasonable for customers, aiming for more moderately priced consumer groups with a price range of \$13 to \$27 in contrast to the high-end pricing strategy of Starbucks.

### **3.6. Luckin's Underlying Logic of High-Cost Operations**

The survey results show that Luckin Coffee has consistently invested money into the growing Chinese coffee market and has continued to seek outside funding to support its operations. For the short-term operation of the store and its expansion strategies, Luckin has finance and principle totaling 3.989 billion yuan as of the end of June 2019. In general, traditional businesses must first test their profit model on a modest scale before replicating and growing based on the results. However, Luckin can forgo the profit model and instead adopt the user or customer growth model as its development rationale as it is an online business. Customers can access free first orders, buy two cups, get one free deal, coupons, and audience by downloading and enrolling the company's mobile application [4]. A specific number of consumers are drawn to purchase due to the 20% discount and other profitable strategies. Luckin Coffee is able to quickly attract a large number of users thanks to its affordable prices and substantial discounts. Based on the enormous number of users of the APP, additional preferential initiatives are then introduced to encourage people to buy Luckin Coffee and raise user awareness of its brand. Viscosity, and ultimately attain profitability through business model

innovation or scale benefits [4]. Ownership of users is equivalent to ownership of the principal in the big data age of the internet. Luckin Coffee's ongoing funding not only enables it to serve a vast number of consumers but also sustains the company's "burning money" business model, giving it a structural cost advantage. The Luckin Coffee marketing strategy works like a snowball, and as more people use the product, more money is drawn in. Eventually, this will allow money to be eventually fed back into the business.

#### **4. Luckin Coffee's Potential Problems**

##### **4.1. High Cost**

Since its founding, Luckin has used extensive expansion strategies, spending a lot of money on consumer subsidies, advertising, and marketing, which has led to operational income that is significantly lower than operating costs. Making a single cup of coffee is not pricey as its primary industry. Luckin's expensiveness is a result of its expansion plan. Additionally, the cost has also significantly increased for the coffee distribution business that Luckin originally planned. The main partner of Luckin is SF Express. In the express sector, SF Express has a high distribution fee. Despite the high order volume, Luckin has a twofold loss due to the average cost per order of about 7 yuan and the high delivery costs. Although the real delivery charge was 240 million yuan, Luckin Coffee only received a total of more than 50 million yuan in delivery fees in 2018 [9]. As the operating cost remains high, it is challenging for Luckin to increase its profitability given the current premise.

##### **4.2. Customer Loyalty**

Numerous marketing strategies for inexpensive drainage were introduced in Ruixing during its early expansion phase. When the ultra-low prices are no longer available, it is questionable that attained customers would be able to return. The cache store takes up the most space among Luckin's shops [10]. Although it offers high convenience, Luckin's brand positioning is hazy because it lacks the spatial variety of traditional coffee shops.

Based on the current average price of 12 yuan and the questionnaire study on Luckin coffee conducted in March 2019, around 36.84% of those who have consumed Luckin coffee had no intention of purchasing it again. 50% of users would stop purchasing if the price rose to 13–26 yuan [5]. It can be seen from the fact that low prices tend to draw unreliable and easily swayed customers.

##### **4.3. Increase of Customer Utility**

Nonetheless, when investors closely examine Luckin Coffee's operating statistics, one will discover that "in-store pickup" in-store orders make up 92% of the total number of orders. As a result, customers may now shop at more locations while spending less time and money on transportation. Customers' perceptions of the "marginal cost" of a cup of coffee have significantly decreased as a result of the store's expansion, which has indirectly increased the public's desire to consume coffee. Data shows that throughout the first three quarters of 2019, there were 4.4 million, 6.17 million, and 9.34 million active users of Luckin Coffee [2]. This expansion in the number of retailers carrying the fission edition is responsible for this. Consumption per person increased by 58.4% to 160 yuan in the third quarter of 2019 from 101 yuan in the fourth quarter of 2018, or per capita consumption [2]. It is clear that Luckin Coffee's financial report's deficit is merely momentary. The demand for coffee in the domestic consumer market could see a blowout rise after the evaporation of time and the ongoing polishing of product quality.



## 5. Conclusion

With the exponential expansion, China's coffee industry is catching up to the average global consumption rate. More and more emerging companies are appearing in people's fields of vision in this cutthroat industry that is still far from being saturated. Luckin Coffee, the first Chinese coffee company, revolutionized the traditional coffee industry with its digital operations, big data planning, and fission marketing. After a long, chilly winter, Luckin Coffee finally saw its first profit, which also shows that its strategic course was on the feasible path. This paper was accomplished following the publication of Luckin Coffee's first quarterly earnings report for 2022, which was also the company's first-ever financial report with a positive operating profit. However, it will require more time to evaluate its plan of action and approaches. Future studies in related fields may view this quarterly report as a turning point and investigate Luckin Coffee's transformation in greater detail.

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