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Challenges and opportunities of new retail horizons in emerging markets: the case of a rising coffee culture in China

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Abstract

Economic growth and a rising middle class consumer base make emerging markets an attractive prospect for many international businesses. Changing patterns of retail in these countries present opportunities for business expansion that many are keen to capitalise on, but also challenges for reaching their ambitions. This paper examines the growth of the coffee shop industry in China, considering its key features dynamics and drivers, in order to address questions about successful retail expansion in emerging markets. It aims to explore how changing consumer cultures have contributed to a rapidly growing industry, what strategies businesses have used to enter the market and maintain growth, as well as considerations for potential retail success in the future.

Keywords: emerging market, retail, China, coffee; consumer culture

INTRODUCTION

A combination of market saturation for some areas of retail in mature markets, with economic growth and rising middle classes in emerging markets, has meant that many international businesses are turning their attention to emerging markets for future growth plans, to exploit that potential of these rapidly transforming markets (Kardes, 2016). Expansion into these markets requires careful consideration, as multiple cases have shown there are many challenges to be faced around different national cultures, as well as institutional arrangements and existing domestic competition (Miotto and Parente, 2015).

The coffee shop industry in China represents such a fast emerging area of retail reaching \$3 billion in revenue in 2016, and forecasts predicting continued positive growth for many years (Euromonitor, 2017). Largely situated in cities, coffee shops in China are becoming an ever-present feature of the urban landscape. In 2017 Starbucks opened its first international 'Reserve Roastery' a 30,000 sq. foot roastery and coffee shop described in the media as a 'coffee wonderland' (Dwyer, 2017). The roastery is located in Shanghai, a city which had 600 existing Starbucks stores; through opening this style and size of store it demonstrated the importance of the Chinese market in its operations. However, the factors behind the growth of coffee shops are multifaceted, driven by the ambitions of coffee shop chains to expand into new markets, as well as changing consumer cultures.

This paper explores the growth of the coffee shop industry in China to consider both the opportunities and challenges that are experienced in an emerging market, utilising the example of China, in an effort to demonstrate how some businesses are navigating the new retail landscapes, and highlighting potential strategies for operating in these regions. A series of recommendations for developing a business in the coffee shop industry in an emerging market, and retail more broadly, are outlined.

EMERGING MARKETS OPPORTUNITIES: THE TRANSFORMATION OF RETAIL AND CONSUMPTION IN CHINA

Emerging markets such as China, India and Brazil among others, have been experiencing economic growth, changing demographics and increasingly cultural transformation, with consequent changes to the urban retail

landscape (Javalgi and Grossman, 2016, Wang, 2011). One example of this transformation are the changes in the Chinese retail sector since the 1990s. In first-tier Chinese cities, in particular, there is evidence of convergence with international norms and trends, making Chinese retailing less distinguishable from what is available elsewhere (Uncles, 2010). New retail formats, particularly super- and hypermarkets and shopping centres, have expanded, while traditional retailing (such as general merchandise stores, family-owned shops and urban markets) has declined (Wang, 2011). Three drivers of transformation in the Chinese retail sector have been identified: retail deregulation, especially lower state control over individual retailers; abandonment of state monopolies, and subsequent opening to private businesses; and introduction of new sources of capital in the retail sector, such as Foreign Direct Investment (Wang and Zhang, 2005). The latter was made possible in part by the opening of the Chinese market for foreign retailers in the 1990s, bringing in new retail formats which were in turn quickly copied by local retailers (Wang, 2011).

The other side of retail transformation in China is changing consumer preferences and demand. Chinese consumers are part of a growing Asian modernism, seeking novelty and who are hungry for experiences (Uncles, 2010). Rising incomes, associated with such changes as increased access to ICT, international media, products and brands are driving the growth of a new generation of middle class consumers (Kardes, 2016). These individuals are often more familiar with western lifestyles and brands than traditional consumers in these countries, and tend to hold aspirations for improving their lifestyles, often using purchasing choices as indications of both these aspirations and status (Eyring, Johnson and Nair, 2011, Kardes, 2016; Kharas, 2010; Sheth, 2011). This new consumer class, with a greater disposable income and growing awareness and interest in imported brands and trends, is an attractive prospect for many international businesses, presenting new internationalisation opportunities.

For many industries it is not sufficient to just transfer existing business models and practices used in western markets into these new emerging markets, which require greater local knowledge of the market, its particularities, and in particular consumer behaviour (Gamble, 2010). While rapid economic growth may present opportunities for business expansion for international businesses, in many cases it also means growing domestic competition which have the advantage of a greater understanding of the national market, its consumer

base and consumer cultures (He and Wang, 2015; Talay, Townsend and Yeniyurt, 2015). There are complexities to many of these emerging markets, which mean that different processes of business hybridization often must take place (Gamble, 2010). Some international business have recognised this and have turned to engaging in partnerships with local companies in order to break into a market, thereby acquiring an existing local knowledge base. Yet, in some cases this has proved restrictive in terms of how businesses have been able to develop, or allowing enough autonomy, and in other cases has not led to the success that had been hoped for (Doherty, 2009; Khan, Lew and Sinkovics, 2015).

There are perceptions that emerging markets are unsaturated and poised for growth, and that middle-class consumers therein present a viable target for business operations (Javalgi and Grossman, 2016; Welsh, Alon and Falbe, 2006). While this may be the case in some sectors and places, there are a range of challenges associated with attempting to establish a presence in these markets. Substantial diversity exists with many of these countries: While much economic growth may be concentrated in urban centres (Sheth, 2011), there are also distinct regional differences (Schlager and Mass, 2013; Peng, Wang and Jiang, 2008), which can be associated with different consumption behaviours (Miotto and Parente, 2015). Furthermore, there is the potential for greater diversity in the consumer base in terms of price sensitivity. While there may be a growing middle class, much of the country, particularly outside the urban centres, may still operate at much lower price points, which may present a barrier for future growth unless business models take this into account (Reinatz et al 2011). As such, businesses are having to consider some of these markets not as a homogenous playing field but as a number of markets which may require a more diversified approach to ensure nationwide success (Kardes, 2016). There is evidence that the convergence between Chinese retailing and international norms and standards which is seen in first-tier cities may not be observed elsewhere in the country, leading to strong national divergence (Uncles, 2010).

Despite these challenges, emerging markets nevertheless remain an active playing field for many international businesses and represent arenas with rapidly transforming retail landscape, offering substantial potential for business growth. One such retail sector is the coffee shop industry, which has been experiencing growth across all global regions, but where perceptions of saturation in western markets has meant many future expansion

plans are turning to emerging markets, particularly China, India and the Middle East. (Ferreira, 2016). The Chinese coffee shop landscape constitutes a microcosm of the dynamics of convergence and divergence of retail in China: it is dominated by Western brands (Starbucks and Costa Coffee), but it is also the setting for strong competition, with Asian chains investing heavily to gain a presence. There is evidence of local adaptation in the offer of the various retailers, while on the margins new providers are attempting to carve new, high quality niches based on specialty coffee. This paper now turns to explore the case of coffee shop culture in China, to demonstrate how market transformation in a specific retail sector illuminates both opportunities and challenges; this is followed by a discussion of potential strategies for operating in emerging markets.

A GROWING COFFEE CULTURE

Coffee Consumption and the Growth of Coffee Shops in China

According to the ICO (2015) the average Chinese is said to drink only 4 cups of coffee a year, compared with 300 in South Korea and 150 in Hong Kong, although this is growing. The *per capita* data for China is heavily affected by the fact that coffee consumption is concentrated in cities, and almost non-existent in most rural areas (Han and Zhang, 2009). The growth in coffee consumption, and the growth of coffee shops spaces as business development opportunities have been recognised by the wider coffee and business community in China. A strategic cooperation agreement between the Food Hospitality World China (FHW) and ACA (Asia Coffee Association) in order to facilitate the promotion of coffee culture through FHW China, one of the largest professional food associations in South China was established in 2014 (WorldEx, 2014). This can be seen as one of many business indicators of the growing importance of the coffee and coffee shop sector for businesses in China. While far from being one of the largest markets for coffee consumption, China's rapid economic growth since 2000 has been linked with a significant increase in the demand for coffee, making it one of the most rapidly growing markets for coffee in the world, with estimates suggesting annual growth rates of 18% until 2019 (ICO, 2015). This is in part a function of the rapidly expanding Chinese Middle Class.

A Rising Middle Class

Drinking coffee is seen to some extent as more of a trend than a habit, a symbol of an affluent lifestyle (Duggan, 2015). Rising incomes, increased living standards, and awareness of western trends by middle class consumers have all contributed to an increased demand for products such as coffee in China (Wang, 2012b). Despite being an expensive product, growth in the sector has been faster for ground coffee compared to instant. Freshly ground coffee is a beverage that tends to be purchased out of the home. This can be seen as part of a broader trend in China around the growing middle classes and associated rising disposable incomes, (Marsh and Li, 2016; Zhang, 2010; Li, 2010; Ren, 2013). As Wasserstrom (2007: 21) highlights ‘the spread of consumerism in step with global trends – symbolized by the arrival of satellite dishes and various new sorts of sites of consumption’, and consequently ‘the omnipresence of Starbucks stores on the streets of Beijing and Shanghai is frequently mentioned as one example of China’s growing taste for foreign food and drink’ (Cunningham, 2010).

These changing consumer cultures have been influenced by a number of other factors, including: growing western influences fuelled by expat populations, increased Chinese mobility and tourism, as well as more traditional influences around the importance in Chinese culture of spending time with family and friends. The growth of coffee shops in China is a predominantly urban phenomenon, where drinking coffee, and frequenting coffee shops is considered a symbol of a successful lifestyle (Duggan, 2015). The service received in some of the western chains is seen as an attraction; the service at Starbucks is considered on par if not higher than many five-star hotels. Wasserstrom (2010) highlights how interviews with several hundred consumers in Shanghai revealed that the majority actually preferred the taste of products from competitors but continued to go to Starbucks because of the service – and to large extent explains why so many other companies have sought to replicate them.

The growth in the number of Chinese people studying abroad, has meant there are an increasing number of people gaining awareness of western brands and experiences which they then wish to experience when returning home. Coffee shop culture appears to be one such experience which many have become accustomed to. A study by ITC (2010) revealed that those frequenting coffee shops were typically 20-40, affluent, fashion conscious urban Chinese. Then there is the expat population in Chinese cities which also seek to experience a

piece of familiarity. In 2004 it was estimated that around 30% of consumers in coffee chains such as Starbucks were Westerners and businessmen from Hong Kong, and this trend remained similar in 2013 (Euromonitor, 2013). More Chinese consumers are becoming exposed to Western influences, and lifestyles. As such coffee shop businesses have targeted young professionals as an audience for their products, a strategy which so far appears successful. Furthermore, international tourism is also an important driver of growth for the industry, as the growing numbers of visitors seek to frequent familiar spaces. This growth has been linked to the rise in the hotel industry but more widely in hospitality industry, including coffee shops (Chon et al, 2013).

The growth of coffee shops in China is strongly associated with rising incomes and need for status, but the trends also suggest a growing interest in the coffee shop as a locale which provides a unique set of functions, leading to the development of specific cultures.

Functions and Culture: The Rise of Third Spaces

China is not the only country experiencing a rise in coffee shops and coffee consumption; in fact, this is a trend taking place to various extents across the globe, with varied levels of attention from the academic community (Ferreira, 2016). Tjora and Scambler (2014) along with other scholars from a range of disciplines including anthropology, sociology and business studies, have made an explicit call for further research on coffee shop spaces, drawing on the work of Oldenburg (1999) to revitalize the concept of coffee shops as 'third places'. According to Oldenburg (1999) the first place is the home, the second is the workplace, and 'third places' are anchors of community life where people routinely meet, often establishments that serve food and drink (of which coffee shops are one example). Oldenburg (1999: 16) describes the third place as 'a generic designation for a great variety of public places that host the regular, voluntary, informal, and happily anticipated gatherings of individuals beyond the realms of home and work'. For Thompson and Arsel (2004: 639), local coffee shops would seem to exemplify Oldenburg's conception of the 'third place - that exists between public and private life and that sustains a delicate balance between the moral economy and the exchange economy'. While Tjora and Scambler pay attention to coffee shop culture from European and Australian perspectives, less has said about other coffee shop cultures, particularly in the Asian context.

However, there has been some significant exploration of coffee culture in Japan, with its history charted by

White (2012), and Grinshpun (2014) exploring the consumer experience of coffee, and the consumption experiences offered by coffee chains in Japan. The development of the coffee industry in Japan is particularly interesting as the ICO (2015) highlighted that the evolution of the coffee industry in China over the last ten years is comparable to the evolution of coffee demand in Japan fifty years ago (ICO, 2015). Japan has what the International Coffee Organisation considers an advanced coffee culture which developed over a 30-40 year period, while China is very much still in its early development. However, patterns of growth experienced in China from 2004-2013 are similar to those of Japan in 1964 -1973 in terms of coffee consumption levels; a more systematic comparison of these developments is needed (ICO, 2015), but it again hints at the potential for significant market expansion.

In other well developed coffee cultures such as the UK, the US and Australia scholars have addressed different elements of coffee shop culture (Ferreira, 2016; Laurier, 2008; Laurier and Philo, 2006; Jones et al., 2015; Oldenburg, 2014). In other areas where coffee shop cultures are developing rapidly, including South Korea, India and Vietnam, attention from the academic community remains sparse, suggesting there needs to be a more systematic approach to considering coffee shop cultures, their impact on urban spaces and communities. This paper however, will focus on China to present the foundations for a more systematic approach to researching the developing coffee shop culture, considering the growth of the industry, the coffee shop landscape, and challenge facing the industry.

COFFEE SHOPS IN CHINA

The coffee shop industry in China reached revenues of \$3 billion in 2016, with the number of coffee shops doubling between 2010 and 2014 (Euromonitor, 2017). China has become a growing market for international coffee shop chains, as well as independents and it is clear that, as in other countries, coffee shop culture in China is about much more than just coffee. Overall, the Chinese coffee shop market remains consolidated with international chains dominating. In 2010 Starbucks had a 66% market share in the coffee retail sector (Barlow, 2013). However, this image is set to change, as competition from different types of coffee shop spaces

and business models emerge to occupy different segments and niches of the market. The coffee shop landscape in China shows the hallmarks of the ‘three waves of coffee’ often referred to in the industry; first the growth of coffee consumption with the appearance of instant coffee; second the rise of coffee shop chains and espresso based drinks; third where consumers seek to understand more about coffee, its origins and brewing methods, treating it more like an artisanal product (Ferreira, 2016). Given these changes in the Chinese market it is possible to identify five phases in Chinese coffee culture, which align with the three waves following the introduction of new products, as shown in Table 1.

[Insert Table 1 about here]

First Wave of Coffee: Home and Fast-Food Outlets

China has historically been associated with drinking tea, and tea culture dates back over 2,700 years. Ingrained in Chinese society, ‘tea culture covers almost all realms of life, both physical and spiritual’ (Xiusong, 1993: 89). Tea is not only an everyday good for consumption but has been integrated into many ceremonial and social occasions in Chinese society (Hinsch, 2015; Wang 2012a). Although China is still predominantly a tea-drinking nation, it is a country where evidence suggests a developing taste for coffee. While tea drinking has a rich symbolic history, coffee drinking in modern China is seen as more of an indicator of a successful lifestyle, a symbol of the western world (Han and Zhang, 2009).

The Chinese coffee market is dominated by instant coffee (99% of retail volume), although roasted coffee is growing (ICO, 2015). Instant coffee is viewed as an inexpensive beverage, which while of lower quality serves a purpose as the ‘afternoon-workplace-keep-everybody-awake’ beverage (Barlow, 2013). Nestlé remains the forerunner in this market, and the brand name has been adopted by many as the generic name for coffee, retaining around 68% market share in 2009, followed by Maxwell House (14%) (ITC, 2010). Instant coffee is the only coffee available to many, due to cost; even in food chains and local shops it is often only instant or canned coffee that is available. Furthermore, some coffee shops will go to great efforts to produce high quality advertising to indicate that they are serving high quality coffee, when in fact it is just more highly priced instant

coffee. There is however a transition away from instant coffee consumption in the home, to ground coffee out of the home, fuelling a growth in coffee shops and coffee culture that is promoting growth in fresh roast and ground coffee. Growth in coffee consumption has tended to concentrate in first-tier cities, but with consumption expanding rapidly in second-tier and third-tier cities too where urbanisation has been rapid over recent decades, it is expected to become a significant market across a range of cities (Barlow, 2013).

Coffee consumption out of the home has largely been attributed to growing outlets in fast-food restaurants, with American chain McDonald's playing a predominant role in this. In 2009 McCafé sections began appearing in existing McDonalds restaurants, providing the new refreshments 'to-go'. The company began to adopt a 'less is more' design strategy for its restaurants including armchairs, more gentle colours, designed to encourage customers to stay and enjoy the environment. They even introduced a new motto building on 'I'm lovin' it', to also have 'make some room for happiness' (Reuters, 2010). By the end of 2013, the US fast food chain McDonalds had 660 McCafé stores in more than 25 Chinese cities, and was planning an acceleration of store expansion which would lead to an additional 2,000 jobs being created in these outlets (Shimda, 2015). Like Starbucks, which faced public backlash for locating in the Forbidden City, McDonalds faced similar response when it opened a McCafé franchise in an historic building in Hangzhou, reiterating the point that while the presence of western style consumerism may be welcomed by some, and in some locations, this does not apply in all cases or areas (Lu, 2015), and care should be taken in location selection.

In 2015 the US-based fried chicken chain, KFC announced it would start selling freshly ground coffee in 2,500 of its stores, in a bid to become a premium alternative to Starbucks. This instantly gave it a footprint larger than Starbucks, it has around 4,500 outlets in China (Wong, 2015). KFC premium coffee would cost about 10 RMB (US \$1.60), almost half that of Starbucks. KFC have drawn direct comparisons with the global coffee shop chains which until recently have positioned themselves as a luxury product. The entry of such a large competitor with much cheaper coffee options has the potential to disrupt the market, or at least the expansion plans of some coffee providers.

Also in 2015, Dunkin Donuts announced it planned to open more than 1,400 restaurants as part of an aggressive expansion plan against decelerating sales in the US, partnering with Golden Cup Pte Ltd (Chen, 2015). In 2013 it had entered into an earlier master franchise agreement with the Fast Gourmet Group to develop in eastern China (predominantly Shanghai, Jiangsu and Zhejiang regions) (Donuts, 2015). While there are over 2,200 Dunkin Donuts in the Asia Pacific Region, there are only a few in the China. Like other coffee shops, it too aims to cater to local tastes with Mochi Ring donuts, for example. Fast food chains have recognised the shift towards demand for these drinks and their environs, introducing their coffee shop style lattes and cappuccinos in some places, and updated décor and furniture. However, it remains to be seen if consumers are willing to pay higher prices in fast food restaurants.

Second Wave of Coffee: Dedicated Coffee Chains

The Major Coffee Chains

Two brands dominate the European and American chain coffee shops present in China, Starbucks and Costa Coffee which are explored in more detail here as they are important to illustrate strategies for success of a coffee shop chain in the Chinese market.

Starbucks, the US based international coffee shop chain, opened its first store in China in 1999 in the Chaoyang district in Beijing, and by 2015 had a network of over 1,700 outlets in over 90 cities, making it one of the largest markets for the business (Kelly, 2017). While Starbucks continued to close some of its stores in the west, expansion had gained paced in Asia. In 2012 Starbucks announced that China was to become its largest market outside of the US, with over 500 outlets which were more profitable per outlet than in the US (Rein, 2012). In 2013 Schulz acknowledged that China had the potential to become the largest market in the future, as the company sought to expand across tier, one, two, three and four cities (Barlow, 2013). By 2017 Starbucks had 2,800 stores in the country and announced an ambitious plan to have 5000 stores by 2021 (Kelly, 2017).

Initially Starbucks targeted expats and tourists, but there is now increased attention paid to local consumers, as coffee drinking and frequenting coffee shops has risen in popularity. Starbucks in China targets consumers

in the upper incomes levels as drinks tend to cost around 50% more than in their US stores; typically, a drinks costs from 30RMB (US\$5). This compares to instant coffee such as Nestle which can cost as little as RMB1.5 (US\$0.10) (Barlow, 2013). Consumers in China pay a premium for visiting Starbucks, as a premium for the coffee shop experience, conforming to the idea that some Western brands are considered as aspirational.

Against criticism that Starbucks is creating a homogenized form of coffee shop across the globe (Clark, 2007), there have been some efforts to localize outlets in China. Examples of this include having larger seating areas as the habit having coffee 'to go' is not as common in China (ICO, 2015). Rather than pushing takeout orders, which account for the majority of American sales, Starbucks adapted to local consumer preferences and promoted the dine-in service (Rein, 2012). By offering a comfortable environment in a market where few restaurants had air conditioning in the late 1990s, this made the locations de facto meeting places not only for groups of friends but also executives. Starbucks adapted its business model to work for the Chinese rather than just transplant the American model.

The Starbucks menu also reflects local tastes (as it tries to in other markets) including green tea tiramisu and Chinese moon cakes. These efforts might be associated as a feature of 'glocalization', adapting a global brand to a local culture (Svensson, 2001). Starbucks has positioned itself as an aspirational brand, and largely succeeded to expand in a market where other western brands had struggled (including Dunkin Donuts, Krispy Kreme, and Burger King) (Wang, 2012b). Success was in part attributed to Starbucks adaption to the local tastes: 'instead of trying to force onto the market the same products that work in the US, such as with cream covered frozen coffee concoctions, Starbucks developed flavours, such as green tea flavoured drinks, that appeal to local tastes' (Rein, 2012).

Starbucks has had to recognise that the places they were trying to expand in were different, not only to other international markets, but within China. In Shanghai, the existing competitors were a mix of some traditional style tea houses, as well as Japanese style coffee houses, as well as coffee shops designed to evoke memories of 1920s and 1930s Shanghai, when the city was seen as the heavily Westernised Paris of the East (Wasserstrom, 2007). To enter Shanghai, Starbucks partnered with the Taiwanese firm Presidential Coffee.

The logic was that a partnership with Presidential would allow greater knowledge of the market, as they had previously been successful in helping introducing 7-eleven stores to the Philippines (Wasserstrom, 2010). Starbucks was presented as a European style coffee shop in the local media, an alternative to Manabe, the Japanese chain that had entered Shanghai in the 1980s (Cunningham, 2010). In June 2011 Starbucks signed an agreement with Maxim Group, its long-term partner to take over 100% of its ownership in certain provinces, and in 2017 bought out any remaining joint venture partner to ensure full ownership of stores in China (BBC, 2017).

In its attempt to move upmarket, Starbucks opened a series of Starbucks Reserve coffees stores, designed to enhance the coffee experience, described in the European context as ‘coffee theatres’ or a ‘cross between a private club and a chemistry lab’ (Smithers, 2015). Signalling to the world the importance of the Chinese market, in 2017 Starbucks opened its first international ‘Reserve Roastery’, one of its largest stores in the world (Dwyer, 2017). These are stores where there are a wide range of specialty beverages and brewing methods for coffee on offer, and a décor that appeals to those looking for stylish venues. It has attempted to position itself as an aspirational brand, with coffee far more expensive than in the US, trying again to show consumption of Starbucks as a status symbol, demonstrating sophistication and the capacity to afford a personal luxury for the middle class (Rein, 2012).

Another of the western coffee shop chains which sought to capture the Chinese market is Costa Coffee, the UK-based wholly-owned subsidiary of Whitbread, which entered China in 2006 and by 2013 accounted for 8.9 of coffee market. By 2017, Costa had 350 stores in China (Gerrard, 2017). To break into China, Costa coffee entered into a joint venture in Jiangsu Province. The logic behind such a partnership is that the Costa Coffee brand on its own as a new entrant to the market would take a long time to establish itself, where as a local company with a knowledge of the local market and its customer base can help establish brands quicker. This did mean that Costa was initially heavily dependent on its partner, particularly to drive the business. Costa has also entered into a joint venture agreement with Beijing Huilan Group, a leading Chinese retailer, in order to expand rapidly into high end business complexes through the retailers, supermarkets and department stores, as well as shopping malls. In 2017 it was announced that Costa was to buy out one of its joint venture partners

(mirroring some of the activities of Starbucks), and ambitious expansion plans for 700 stores by 2020, which would still place it significantly behind the market leader (Gerrard, 2017).

The Challenger Coffee Chains

It's not just western companies that have acknowledged the potential of the Chinese market. In particular, successful coffee shop chains from elsewhere in Asia have started to expand in China. Large South Korean brands such as Maan Coffee and Café Bene, Japanese brands such as Manabe, and Taiwanese brand UBC have helped pave the way for higher quality coffee in China.

Maan Coffee is viewed as a success story of a Korean-owned brand designed specifically for the Chinese market. The South Korean Ja Sang Shin opened 100 branches of Maan coffee in China with a distinctive decorative style which resembled a magic school (Wang, 2015). Maan, unlike many of the Starbucks stores, are located near parks and schools in residential neighbourhoods, designed to create a relaxing, less business-oriented environment (Wang, 2015). This is seen as part of a trend of moving away from business districts where competition is fierce. For Maan 'everything here is designed for the Chinese', and the chain, much like others, has ambitious plans to double to 200 stores by the end of 2020 including a megastore to over 3,000 s feet in Haikou, plus two coffee museums in Chongqing and Beijing (Wang, 2015). Maan's sales grew to \$70 million in 2014, twice that of the previous year (Wang, 2015); demonstrating how particular attention to store location can be a factor in success.

In 2015 Gloria Jeans, one of the other largest global coffee house chains originating in Australia, announced that it would attempt to expand in the Chinese market, partnering with the Chinese restaurant group Gou Bu Li (which operated a few existing Gloria Jeans stores) (SBS, 2015). Coffee Bean & Tea Leaf, a Los Angeles-based company, intended to open 700 stores in China in coordination with the South Korean retail conglomerate e-land which already owned an operation of over 60 fashion brands in Korea and 11 brands of hotels, and already operates international brands in Asia (Brown, 2015).

The Emerging Domestic Challenger Coffee Chains

Historically there have been few domestic coffee shop chains in China, although this is changing. The Hong Kong-based Pacific Coffee has decided to enter the mainland Chinese market. In 2010 the China Resources Enterprise (CRE) acquired 8% of the company and outlined a goal to open 1,000 coffee shops in China (Leung and Lui, 2010). CRE already has an extensive retail network of over 4,000 multi-format stores, which it hopes would provide Pacific Coffee with a competitive advantage to take over market share to reach their goal of become the number one coffee shop chain in China (Barlow, 2013).

Some domestic chains have attempted to capitalise on the Starbucks model and have even attempted to model themselves as such, as seen with the Shanghai Xingbake coffee which had a logo not too dissimilar to the Starbucks green circle and logo. Starbucks successfully sued Shanghai Xingbake for copyright infringement in 2006 (BBC, 2006). The Chinese domestic chains tend to pay more attention to the environment being provided to consumers rather than the coffee itself, playing on the romantic image of the old world roaster (Wasserstrom, 2010).

Third Wave of Coffee: Specialty Coffee Shops

While the coffee culture in China is not as developed as some western countries, many places particularly in Beijing and Shanghai have an increasing presence of specialty coffee shops where more emphasis is placed on high quality coffee, coffee origins as well as a range of brewing methods. Coffee shops like Coffee shop del Volcan offer coffee served by slow-brew methods such as siphon in addition to traditional espresso-based drinks (Duggan, 2015). By emphasizing the handcrafted nature of coffee through the roasting and brewing methods, these coffee shops introduce customers to the so-called “third-wave” coffee experience that is associated with specialty coffee (Ferreira, 2016). In the past, the lack of quality equipment, and experienced baristas to manage the shops, limited the dynamism of the industry in cities like Shanghai and Guangzhou. Yet despite these limitations, coffee culture is maturing in China. Several places in Beijing offer specialty coffee courses on making espresso, various brewing methods, and cupping for baristas and roasters interested in honing their skills and getting certified through the Specialty Coffee Association (SCA) (Wang and Newton, 2016).

In Beijing, independent coffee shops have mushroomed throughout the city's famous *hutongs* (traditional lanes), particularly those that are now rapidly gentrifying. In some of the first-tier cities such as Shanghai and Beijing there is a growing demand for higher quality coffee (Wang and Newton, 2016). The Shanghai based Seesaw coffee shop, places great emphasis on the education of its customers, and this is integrated into the design of the coffee shop. A bar is laid out like a stage to see the baristas perform (very much like at the London coffee festival). The Seesaw coffee shop also has a 'coffee academy', with barista training programs and classes that open to the public, again much like in the UK (Barlow, 2013); here demonstrating ways independent businesses can carve their niche in the market.

The Shanghai-based Coffee shop de Volcan was established as a testing space for customers to try coffee which would then be provided as a home delivery service, although it soon became a popular retail coffee outlet in itself. The owner observed an interesting trend when the coffee shop was opened. Initially, no prices were displayed as they intended to give the coffee away for free, as an advertising strategy. But despite no prices being displayed, customers ordered their drinks without asking, only a few inquired about the price. This indicated that most of the consumers were not price sensitive, rather they simply sought the best coffee in Shanghai. According to the owner, this allowed the coffee shop to focus on achieving the highest level of quality and service (Barlow, 2013).

Often these independent coffee shops seek to present themselves as unique, with an individual style of decoration. Regular trends include, but are not limited to, bookshelves jam-packed with novels, walls of post-it notes scrawled on by young couples and friends, romantic Mandarin-language ballads on repeat, stuffed toys of sometimes gigantic proportions, as well as a jumble of vintage and modern artworks and photographs. It can be argued that these coffee shops can also represent some of China's newly emerging design tastes and artistic flare. Whether these tastes may have been different without the expansion of western brands into Asia remains to be seen, but one thing that is certain is that the emerging styles often show evidence of local historical influences (for example, earlier 20th century postcards all over the walls (Wasserstrom, 2007: 24) and so when consider new store locations, again the local context is of needs attentive consideration.

The picture of the Chinese coffee shop market presented so far points to a booming market, in which a variety of businesses compete to provide increasingly-discerning consumers. However, this competitive dynamic may also be a source of challenges for the industry. The next section analyses the opportunities and challenges for the coffee chain retail sector in China.

OPPORTUNITIES AND CHALLENGES FOR COFFEE SHOPS IN CHINA

The analysis presented has shown the vibrancy and dynamism of the coffee shop industry in China. This suggests there are opportunities for growth across the market; however, the analysis has also suggested challenges ahead. This section indicates what these might be, before looking at the landscape of internationalisation of coffee shops in emerging markets more generally.

Opportunities for Growth

The Major Coffee Chains

For the major coffee chains (Starbucks and Costa), the Chinese market offers continued opportunities. Seen as luxury brands, and associated with affluent and urban lifestyles, these companies are able to sell their product at price points which allow them to be profitable. In turn, that profitability could help the companies expand further. This capacity to finance rapid expansion is important at a time when both companies find themselves in charge of their own strategies. This moment comes about for two reasons: the unravelling of local partnerships, and the lack of development of the Chinese franchising market.

Having partnered with local businesses in order to enter the market and gain local knowledge, both Costa and Starbucks have now ended such partnerships, as they stopped the majors from expanding at the pace, and in the style they wanted to. This should allow each of the companies to focus on its values, products and image, rather than seeing them potentially diluted by local partners with different agendas. In terms of franchising, while in Western markets the franchise model is used by these coffee shop chains, this has not worked as well

in China. While the franchise model typically allows foreign companies a low-cost rapid growth model providing easy access to a new consumer market, with faster brand recognition, China's franchise culture is not well developed. As a result of these trends, Starbucks and Costa have an opportunity to consolidate their position as aspirational brands and continue to sell their products at a high price point, rather than becoming commodified.

The Challenger Coffee Chains

The emergence of Challenger Coffee Chains (both foreign and domestic) is predicated on the fact that coffee consumption in China has been growing at 15% per year since 2015, and is expected to continue at a comparable pace (Euromonitor, 2017). The major chains are unlikely to be able to expand at a rate that allows them to supply all this demand, so there is a significant opportunity for challenger coffee chains.

A specific gap which may be explored by challenger coffee chains is growing demand for coffee shops in second- and third-tier cities. Bearing in mind the great asymmetries between the large, more affluent cities and other urban areas in China, consumers in these cities are more likely to be price-sensitive. Some of the challenger coffee shops may be equipped to explore this, providing a coffee shop experience at a lower price point. They may also be capable of adapting better to local preferences and needs – and Chinese challenger chains could be especially well-equipped for this.

In addition, most of the challenger coffee shop chains have established local partnerships, allow them to launch with a large number of shops. This could prove to be an important advantage in the search for scale and market share.

Specialty Coffee Shops

Following the trends observed elsewhere in the world, China has seen the emergence of the first few third wave coffee shops. Characterised by an interest in quality and the methods of sourcing and brewing coffee, 'third wave' specialty coffee shops also offer differentiation and new experiences for the discerning consumer.

Their emergence suggests that the Chinese coffee shop industry is not only growing quantitatively; it is also experiencing differentiation, with the appearance of a new segment of consumers who have both interest and buying power; and therefore a range of potential opportunities for growth.

In part to support this growing taste for coffee there is also a burgeoning coffee growing industry, particularly in the Yunnan region which is developing an international reputation for its specialty coffee (Wang and Netwon, 2016). Such growing tastes for coffee are likely to fuel the existing expansion of the coffee shop industry, providing a more diverse business base for the industry. With the right business strategies there is room for significant growth of this sector for both international and domestic companies who can cater for the diverse consumer base that has developed, beyond the urban middle classes; such strategies then have the potential to be transferred to other areas of the retail sector or to other emerging markets. Despite these opportunities, the sector also faces important challenges. The next section addresses these.

Challenges to Growth

The Major Coffee Chains

In internationalisation contexts, it is important for companies to take into account detailed information about the local communities they are entering into. By focusing their alliances with local partners and finishing on their values, products and brands, Starbucks and Costa risk losing an insight into Chinese consumers' preferences and demands. This could see the majors losing track of developments in the market. A second problem is potential encroachment by competitors in the majors' market share. There is a perceived lack of understanding about how to manage a coffee shop in China, as many of the domestic coffee shop chains adopt similar models to that exhibited by western brands, copying what is seen as a successful business model which may not always be appropriate for the Chinese context.

Continued growth is reliant on the expansion of the middle class, but also diversification of activities to cater to the needs of different consumer groups. While in Europe drinking coffee in a coffee shop may be an everyday activity, in China it remains a premium activity out of reach of average workers. The high price of coffee in many international coffee shop chains excludes many consumers, but may provide an opportunity

for the domestic coffee shops. Many Chinese consumers simply cannot afford to adopt the Western habit of drinking in coffee shops under the current price models (Yingzi and Zhouqiong, 2015). The prices of espresso-based beverages are more expensive in China than in the US: where a Grande latte at Starbucks costs around US\$3.75 in the United States, the same drink would cost almost US\$4.50 in Beijing. To add to this price difference, the income of city-dwellers is also lower than that of the US. With high prices and lower earnings, fewer people are able to afford a daily coffee habit, choosing instead to drink pre-bottled teas and juices; this highlights that coffee shops may wish to consider the range of products they offer to attract a wider consumer base.

Finally, by placing and pricing themselves a luxury brands, the majors also risk backlash. A study by CCTV in 2013 compared the price of a latte to elsewhere in Starbucks branches around the world: the highest was in Beijing at 27RMB, compared to Mumbai which would have been around 14 RMB in equivalent currency. As a result, Starbucks faced an intensive negative campaign by the China Central television media, accusing the company of overcharging local customers (Shimada, 2015). The resulting backlash could hurt the companies' reputation.

The Challenger Coffee Chains

Challenger coffee chains face an uphill battle to gain a foothold in the increasingly competitive Chinese market. The influx of brands and capital has the potential to outstrip demand, as consumers in second- and third-tier cities in particular take time to adopt coffee drinking out of the house. Absence of demand could act as a disincentive for challengers to innovate and attempt new models. This could mean that the prevalent business strategy in the sector remains to imitate the major chains.

It is also not clear that challenger chains will be able to charge the same prices as the majors. This could hurt their profitability and, consequently, their motivation for further expansion. The discussion on price points for coffee across China is set to continue for the foreseeable future.

In addition, there are operational issues to be considered. Amongst them, the various challenger chains have pledged to open several thousand new coffee shops, across all of China, in a relatively short period of time. This will require important investments in terms of supply chains for goods, as well as training for potentially dozens of thousands of baristas. In mature markets such as the UK, these operational issues have been shown to be important obstacles to the industry. Finally, there are remaining question in terms of whether or not the current rate of growth of coffee demand is sustainable. Challenger chains are dependent on new consumers joining this market, in areas where coffee culture is not rooted. It is unclear if this can happen quickly, despite growing consumption rates.

Specialty Coffee Shops

Specialty coffee shops in China suffer many of the same challenges as specialty coffee providers elsewhere. However, many of the independent coffee shops cannot compete in size with the larger chains which cannot afford the rapidly rising rents and costs of goods. Café Zarah, which opened in 2007 in Beijing, began with only 80sq metres but has more recently tripled in size to cater for 120 people (Baleneri, 2015). But with increasing real estate prices and commodity costs, business is challenging. Rent for this space has increased five-fold in 10 years to \$11,000, and there are numerous examples of coffee shops closing down (Baleneri, 2015). This raises questions about how international coffee shop chain expansion might be jeopardising the viability of the smaller independent businesses (not unlike the situation in many US and European cities where international chain expansion has been widespread).

Internationalising Coffee Shop Retail in Emerging Markets: the Importance of Coffee Culture

The market landscape for coffee shops in China has been transformed over the last two decades as more international and domestic coffee shops have sought to expand in Asia and introduce a new population of consumers to the possibility of not only drinking coffee, but also using coffee shop spaces. Forecasts for the industry remain positive, as many coffee shop businesses have ambitious expansion plans, building on positive consumer demand. The expansion of coffee shops in China has been driven by more than just an increase in consumption of coffee but by the increase in middle-class consumers seeking products associated with Western

lifestyles, an increase in international tourism, and the move towards socialising in coffee shop spaces as more popular activity, with similar trends taking place in India and the Middle East.

Compared to mature markets such as the UK, USA or even Japan, the coffee shop culture in China is still in relatively early stages of development, and as such presents continued potential for growth. Lessons learnt from existing activities in the coffee shop sector and other retail activities in China suggest a number of avenues for action for businesses considering entering into the coffee shop industry (and broader retail activities) in an emerging market, and for those who wish to maintain sustainable growth in these markets. The emergent state of coffee culture is partly a result of a relative lack of understanding of wider coffee and coffee shop industry developments globally, as well as historical features of the Chinese market. This state of affairs constitutes a very important operational challenge for the industry in general. In order to maintain rapid development, support from the wider coffee industry will be needed, including importers, roasters, processors and equipment providers and barista trainers, which to date have not been expanding at the rate experienced by the coffee shops themselves.

STRATEGIES FOR FUTURE GROWTH AND A FUTURE RESEARCH AGENDA

This paper was designed to act as a starting point for a more systematic investigation of the how different industries are developing in emerging markets. Emerging markets are often presented as an attractive arena ripe for growth, with international businesses from across economic sectors keen to capitalise on rising incomes, growing middle classes and the opportunity to expand their international network. The coffee shop industry in China is a dynamic part of the retail sector with forecasts predicting continued growth for the foreseeable future. As coffee shops become ever present in towns and cities across China they have the potential to play an important part in urban lives. Similarly, in other retail and commercial sectors the potential for growth exists, not only in China, but across emerging markets. The results suggest three recommendations for companies looking to internationalise in emerging markets.

The first recommendation concerns *culture*. Consumption of goods and services involves a series of practices, some of which may not present in emerging markets. Cultures – shared social values – can take long to take root. Furthermore, they are not geographically constant, but vary from location to location. It is a culture of visiting coffee shops and using the space for different activities which is supporting the robust growth in demand for coffee in China; it is not a taste in coffee *per se*. Businesses looking to internationalise can and should support nascent cultures; as seen in the case of coffee shops in China, this can be done by looking at their offer not in terms of what they sell (coffee), but of what the consumers are buying (a third space). This opens a need for international businesses to benchmark their local competitors. Given these businesses are likely to have a more in-depth knowledge of local cultures and consumer behaviours, their activities should be observed closely to consider what appears to be successful, to identify if there are gaps for future growth, or if there is some way to differentiate business operations to attract consumers.

The second recommendation relates to *partnerships*. As in many other industries, businesses looking to internationalise in China have opted to partner with local businesses. Interestingly, the major chains are now moving away from those partnerships, while challenger chains are still launching active partnerships. It would appear that partnerships are useful in the early stages of internationalisation but prevent control after the chain is established in a country. Businesses looking to internationalise can and should start in emergent markets in partnership with local companies but should also have an exit strategy which allows them to regain control once established.

The third recommendation involves *segmentation*. As the market for coffee develops, different segments begin to emerge, sometimes changing the position of brands and companies. While Starbucks and Costa remain key players in the Chinese coffee shop market, they now face competition from a segment offering arguably value (challenger chains), as well as a higher, more luxurious offer from specialty coffee shops. As a result, the majors risk finding themselves increasingly offering a commodity product and experience, while being perceived as lower value due to higher prices. Businesses looking to internationalise should observe the results of their efforts to develop markets. In particular, they should consider regional variations within the market, and especially the demographics and consumer cultures associated with the different regions. In addition,

future business models should consider incorporating price differentiation of products and services in order to target a broader spectrum of consumers. Businesses also need clear strategies of how they want to place their offer in those markets, in the coffee shop industry as in other areas of retail there are niches to be explored. For those in the coffee industry this could be the addition of a barista training school (which also provides courses for consumers too), an instore roastery (to provide more of a sensory experience in the coffee shop) or focusing on a particular theme to differentiate the business from others (board game cafes and cycle cafes for example have been popular in some countries).

This paper was designed to act as a starting point for a more systematic investigation of the how different industries can develop in emerging markets. Internationalisation often holds the promise of entry into dynamic sectors undergoing significant transformation, with the potential for substantial future growth if the right strategies encouraging consumption are deployed. What the analysis has shown is that, while such opportunities exist and can bring success to internationalising firms, there is a need to monitor the evolution of the market and update strategies accordingly. Success in growing specific market brings profits, but also competition, and internationalising businesses can see their position eroded by new entrants and by a slowdown of growth. Reacting to gradually-maturing markets requires an understanding of how much to adapt to the local tastes, needs and ability to pay for the product without compromising the brand. It also requires an understanding of how to continue to support the development of new consumer cultures, which integrate local values with individual aspirations. Businesses which successfully navigate these (sometimes) conflicting needs are not only purveyors of products and services, but market makers in their own right, opening new horizons to entirely new industries.

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Table 1. Timeline of Chinese coffee and coffee shop culture

| Date | Wave of coffee | Phase | Features | Exemplar businesses |
|--------------|----------------|---------------------------------------|--|--|
| 1970s | First wave | Instant Coffee | Emergence of instant coffee | Nestle Maxwell House |
| 1990s | | Arrival of ground coffee | Emergence of fresh ground coffee, expanded through franchise model. Introduces the flavour of coffee to a wider audience. | UBC coffee Nestle |
| 1998 | Second wave | International coffee shop chain entry | Entry of international coffee shop chains such as Starbucks to the Chinese market, introducing more espresso-based drink Consumers treat such chains as symbols of western lifestyles. | Starbucks |
| 2005 | | Growth of coffee shop chains | Growing number of coffee house chains (both international and domestic) creating a more competitive environment. | Costa Coffee Starbucks Maan Coffee Pacific Coffee Coffee shop Bene Zoo Coffee |
| 2010-Present | Third wave | Independents | Rise of independent coffee houses and specialty coffee houses | Grenadier coffee shop (Beijing) Sumerian (Shanghai) Home coffee shop (Tianjin) Coffee shop 27 (Beijing) |

Source: Authors.