



Driven by continued economic growth, rise of major consumer groups, favourable policies, capital investment, the convenience store industry has experienced stable growth. Digital-centred transformation will pioneer the next stop for this industry and become crucial means to cope with changes and challenges. Participants from outside are swarming into this industry and may probably become the key force reshaping the convenience store landscape.

Convenience Store Turns the Corner

BY / Tianbing Zhang, Lydia Chen, Alaric Li

Policy support and steady capital inflow fuel a sustainable growth in convenience store industry, making it the main growth driver in the retail market. In order to shed light on its development, this article analyzes convenience store industry from three aspects: development prospects, the path to business transformation, and potential game-changers in the market.

Convenience Store on the Upswing, But for How Long?

As physical retailing withers and supermarkets and department stores struggle in sales stagnation for the past three years, convenience store retailing has picked up the ball and run with it. Department store sales have shrunk since 2015, despite in a context of global recession, convenience store sales have grown at a steady 9% per annum for the past seven years. Will this upswing last? We at Deloitte believe the good times are just beginning.

Development opportunities in a competitive, fragmented market

Due to cultural and economic reasons, convenience stores are widely dispersed and unevenly distributed across China, with no player in monopolistic position. Meiyijia, whose sales ranked No. 1 in China, has merely 10% of market share. The HHI of the ten largest companies in the convenience store industry attains only 378.6 (an HHI below 1000 indicates a competitive industry), indicating a relatively unconcentrated market. Shanghai and Guangdong are the only exception with more than 5,000 convenience stores, whereas that number in most regions is less than 1,000. This unequal regional development holds untapped potential for the convenience store industry. Moreover, lower labor and rental costs in second- and third-tier cities make convenience store an attractive option.

Mature markets' experience reveals the potential in China's convenience store

The development of the convenience store industry is closely related to the level of economic development and urbanization in a country. In Japan and Taiwan, when the GDP per capita reached around \$3,000, their markets entered the 'preliminary stage' for convenience stores; once their GDP per capita reached \$10,000, the convenience store industry entered the 'mature stage' where competition between players intensifies and profit margins decreases.

Population density is another major factor for the development of the convenience store industry. Areas with higher population density are more favorable to the development of convenience stores. The population density of the top 50 cities in China is above 640 persons per square kilometer, much higher than the average density of Japan or that of United Kingdom. Even the population density of the top 90 cities in China is above 200 persons per square kilometer. Hence, from a population density perspective, a sizeable population base is already in place for convenience stores in China.

From 2006 to 2016, convenience store sales in Japan and the United Kingdom rose every year. In Japan, the proportion approached 9% of total retail sales by 2016, a 3% increase as opposed to 2006. In China, although the proportion of sales taking place in convenience stores has risen since 2014, the figure still hovered below 1% by 2016. Hence the convenience store industry has a growth potential in China in the years to come.

Younger generation provides support for the sustainable development of convenience stores

Rapid economic development in China brings about jobs and steady income growth for the young with growing purchasing power. Unlike preceding generations of consumers, this generation is less price sensitive and sees shopping as a lifestyle choice. Therefore the millennials care more about having a convenient, personalized and high-quality shopping experience. Data from FamilyMart stores in China shows that this new generation of consumers has become the driving force in the growth of the convenience store market. Currently, 20 to 40 year olds consumers account for 88.4% of the visitors to FamilyMart stores. Statistics from 7-Eleven stores in China also show that 20-40 year-olds account for 88% of their clientele. Company employees are the main consumer group.

In Japan, a survey found that between 1997 and 2015, consumers in their 20s were the most frequent visitors to convenience stores. Though lagging behind consumers in their 20s, consumers in their 30s, 40s and 50s also showed an increasing frequency of visit. One observation is the number of visits by consumers in their 40s rose from 9.8 to 21.3 during this period. Similar to what data reveals in Japan, companies such as FamilyMart and 7-Eleven in China also report that the younger generation is the major contributor to sales and growth.

Policy support boosts the development of the convenience store industry

Policy support is an important catalyst for the current rapid development of the convenience store industry. In 2015 the General Office of the State Council released its first national level policy document, comprehensively and systematically promoting the development of the Service Industry— *Guiding Opinions of the General Office of the State Council of the People's Republic of China, on Speeding up the Producer Service Industry to Promote Industrial Restructuring and Upgrading*. This document sets up guidelines for consumption upgrade and enhancing the scale, quality and efficiency of the service industry. While policy support for the convenience store industry in the south is better than that in the north, some forward-looking policies have recently been introduced in northern China. For instance, Beijing municipal government issued a series of documents including one on industry standards for convenience store chains in 2016, which has promoted brand development in the convenience store industry in Beijing.

Capital becomes the driving force in the convenience store boom

Stable performance, high-frequency consumption and convenient service generate growing interest in the convenience store industry in recent years. This enthusiasm reached a peak in 2017 when the industry received large injections of capital. Companies that have received financing generally fall into three categories: innovative convenience stores, unmanned convenience stores, and service providers.

Table 1 Domestic convenience stores and related corporate financing (incomplete statistics)

Brand Name	Financing Date	Financing Details	Business Model
Xiaomai	2017.07	RMB125 million in Round A	Unmanned
Pinpianyi	2017.04 2017.07	RMB1 million level in angel investment round RMB10 million level in Round B	B2B Service Provider
Huoquanquan	2017.07	USD10 million in Pre-A Round	B2B Service Provider
F5 Future Store	2017.06	RMB30 million in Round A+	Unmanned
Bingo Box	2017.05	Over RMB100 million in Round A	Unmanned
Today	2017.05	RMB30 million in Round A+	Convenience Store
ABLife	2017.03	RMB200 million in Round B	B2B Service Provider
Bianlifeng	2017.02	RMBx00 million in Round A	Convenience Store
Huimin	2016.09	RMB1.3 billion in Round B	B2B Service Provider

Data Source: Open source, Deloitte Research.

Based on the analysis above, Deloitte believes that a new generation of consumers who value convenience and satisfaction in their shopping experience, will ensure the sustainable development of the convenience store industry in the near future. Moreover, policy and capital support will accelerate the industry's development, leading to increasingly fierce competition among companies. This will force companies to innovate and to differentiate themselves from their competitors in order to survive.

The Next Step in Business Transformation

Changes in consumer preferences, the impact of e-commerce and an outdated business model are the reasons behind the sluggish performance of the traditional retail industry in China. In the meantime, e-commerce companies are actively expanding their offline businesses to snap up market share, whose technology and business model have transformed the landscape of physical retail industry. As E-commerce companies swarming in the retail market, convenience store companies are forced to prioritize their customers' need by integrating digital technology in their daily operations in order to provide continuous, high-quality service. But how can it be achieved? Here are some suggestions on where the convenience store industry is heading next.

Back to the roots of business: prioritize consumer's needs and build core competitiveness.

The essence of the retail business is to satisfy consumers' ever-changing needs at all times. Hence, convenience store enterprises should strive to answer what goods and services to provide

and how to satisfy consumers' needs. Branding, catering services and greater involvement in the production process are all major initiatives that convenience store companies have adopted in order to meet consumers' needs.

Category optimization

By providing goods and services to consumers, convenience stores play an important role in defining consumer's needs. Whether their goods and services can effectively meet the consumers' needs directly influence consumers' experience. Therefore, all leading convenience store companies have been constantly investing in goods and services and have set continuous category optimization and upgrading as the core of their decade-long strategy. (Category optimization means to better satisfy consumers' needs by optimizing the of goods and services)

Differentiation from competitors through catering services

By offering a large variety of food options, convenience store companies differentiate themselves from competitors and create a unique brand image with iconic foods and services, thereby enhancing consumer loyalty. According to 7-Eleven's operating data in China, FF (Fast Food) products have become the largest component of sales and gross profit of convenience stores, accounting for 42.9% of total sales and 46.6% of gross profit.

Branding

Branding is another important factor in the business strategy of global convenience store companies. Private labels enable convenience stores to ascribe 'uniqueness' to products and to better meet the different needs of consumer groups. 7-Eleven is a case in point when it comes to developing private labels. By the end of FY 2016, the sales of Seven Premium, a private label of Seven Eleven Japan (SEJ) had exceeded one trillion yen, making it currently Japan's largest private label. Seven Premium has contributed over 60% of SEJ's sales growth for three consecutive fiscal years since 2014, a major growth driver for SEJ's growth. In order to better capture the needs of different consumers, SEJ has successively launched Premium Gold, a private label of even higher quality, and Seven Lifestyle, a private label focusing on design, detail and material.

Figure 1 Market position of SEJ's private labels



Data Source: SEJ Annual Report, Deloitte Research.

Greater engagement in the entire production chain is indispensable to the development of private labels and fast food. 7-Eleven has engaged thoroughly in the production chain. It has developed its own production line to more thoroughly integrate and optimize the supply chain. Data shows that factories of exclusive use make up more than 92% of factories. By deeply engaging in production and forming a community of interest with suppliers, convenience store companies can better control the type and quality of goods, their cost and distribution. This approach also encourages suppliers to upgrade products, thus enhancing the overall performance.

Business operation innovation and retail store optimization

Convenience stores are the core carriers connecting consumers with goods and services. Therefore, operation innovation and store optimization are key aspects in which enterprises need to invest.

Upgrading and remodeling existing stores

Upgrading and remodeling existing stores allow companies to use store space more efficiently. Installing new equipment will improve operational efficiency and consumer experience. Large convenience store chains are well aware of this. For example, in order to better meet the diverse needs of consumers, Lawson (Japan) aims at increasing the quantity of merchandise by 10% to 3,500 items through its 1,000-Day Plan. It also plans to invest 5 billion yen in upgrading the fixed equipment in its stores, enabling its 5,000 stores in Japan to expand the supply of merchandise in the future. Furthermore, in order to increase efficiency by 25%, Lawson plans to upgrade the store system by investing in terminal replacement, semi-automatic ordering systems and installing a paperless business.

Multiple business operations

In order to increase what they have to offer in response to customers' increasingly personalized needs, convenience store companies have started to develop various types of business operations. For example, Lawson has launched multiple new business operations, including Natural Lawson, Lawson 100 and etc. Natural Lawson focuses on beauty and health products, delivering a more "beautiful, healthy and comfortable" lifestyle to consumers. Lawson 100 is a 100-yen shop with all goods priced at 100 yen, targeting the elderly and small families. It mainly offers a wide range of fresh fruits and vegetables as well as small packaged goods, providing consumers an economical, simple, and comfortable shopping experience.

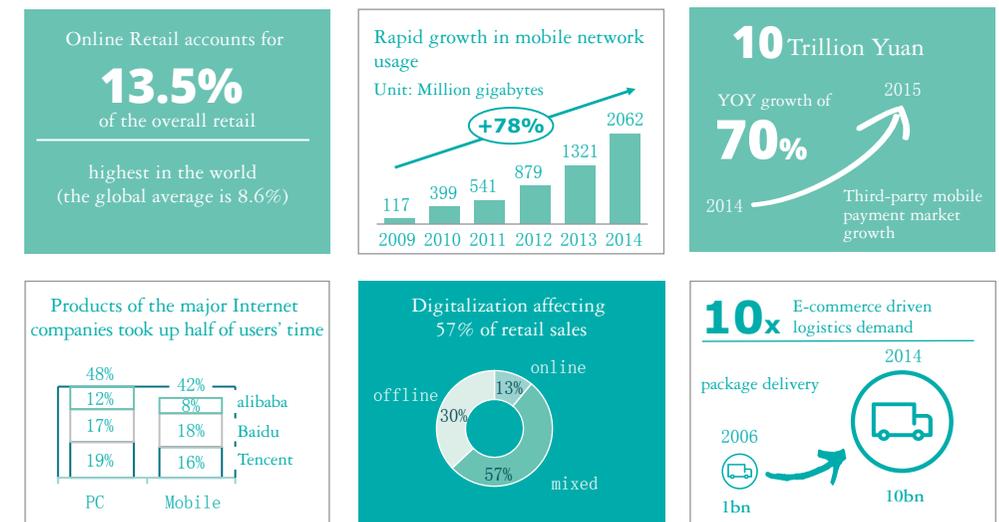
More diversified services

As a regional focal point for consumers, convenience stores have the potential for developing diverse businesses. In Japan, Lawson is committed to becoming the fourth largest infrastructure in the community by offering a wide range of services. In order to achieve this goal, Lawson has cooperated with local health management companies to set up new comprehensive convenience stores with consulting counters catering for the elderly. FamilyMart is also joining forces with pharmacies to strengthen its medical supplies section and provide quick medical care for the elderly.

Digitization helps convenience store companies reconstruct the value chain

As shown in Deloitte's research on digitization in China, market trends and consumer trends in China's retail market and the rapid digitalization in China are driving the transformation of China's retail industry. China's unique digital environment and the continuous deepening of digitization have had a profound impact on the retail industry.

Figure 2 China's unique digital environment

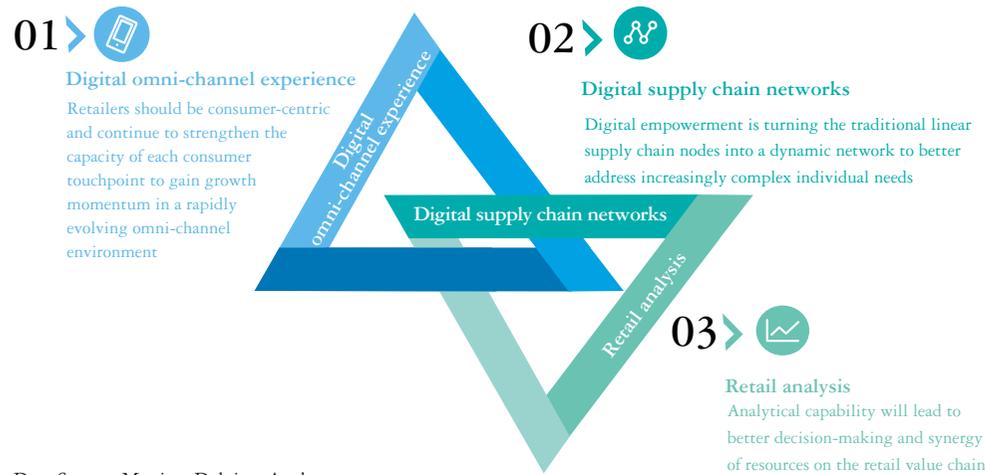


Data Source: Monitor Deloitte Analyses.

Take into account industrial changes and China's unique digital environment, Deloitte Research has identified three key elements for business to heed in this new market landscape. These are: digital omni-channel, digital supply chain networks, and retail analysis. By strengthening consumer touchpoints, digitally integrating and optimizing the supply chain, combined with systematic retail analysis, convenience store companies can optimize and coordinate all links in the value chain.



Figure 3 Deloitte's Three Dimensions for Retail Transformation

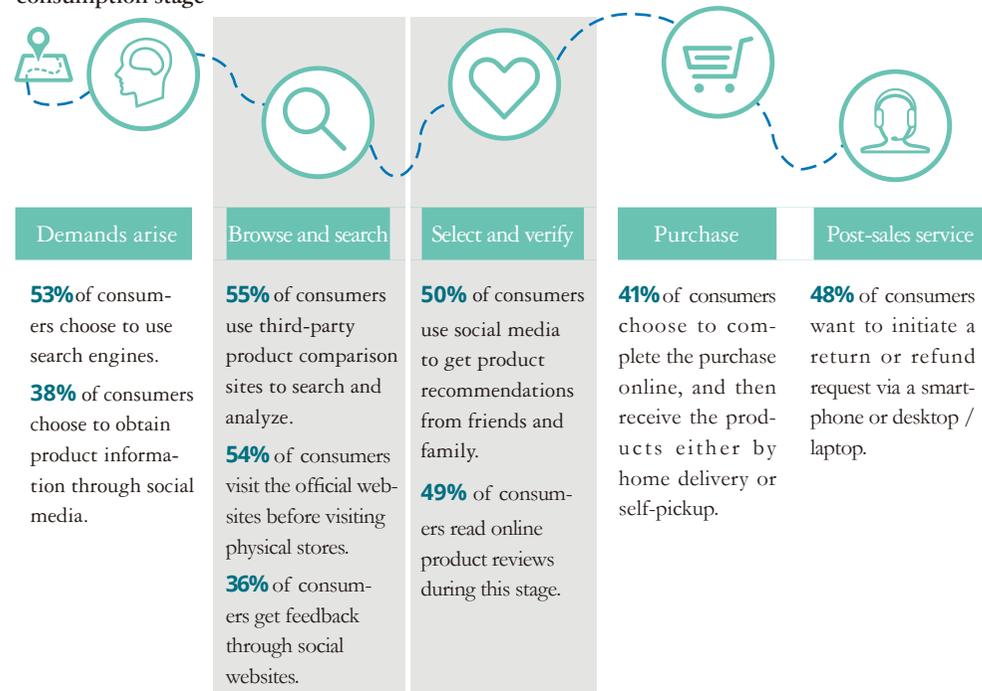


Data Source: Monitor Deloitte Analyses.

Digital omni-channel experience

Consumers will become the center of the new retail ecosystem. Retailers will need to establish a seamless and continuous connection with consumers, guaranteeing a high quality shopping experience through ubiquitous shopping scenarios and interactive channels. For this purpose retailers will need to keep improving their capacity to perform the core tasks in retail business.

Figure 4 Interaction with digital carriers in each consumption stage



Data Source: Deloitte Research.

In view of the current consumer trends and the digital environment in China, Deloitte believes that in the process of building omni-channels, enterprises should focus on and continue to improve their retail capability in three main areas: digitization, commerce, and service.

Figure 5 Key Aspects of Omni-channel

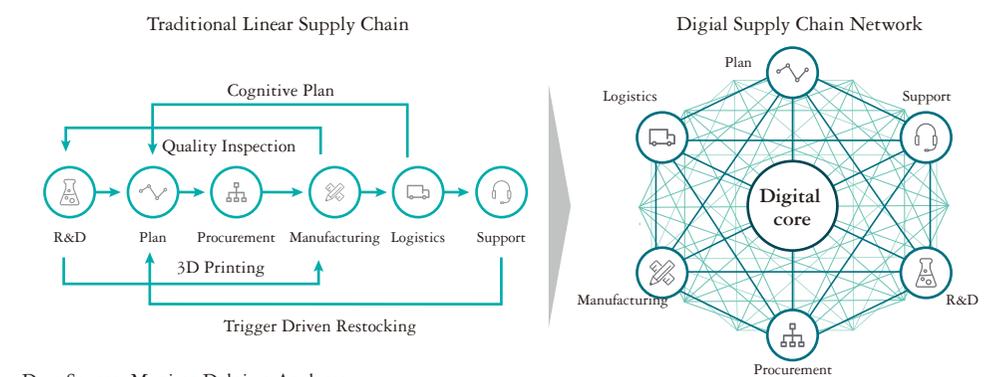
Retail Focus	Digitalization	Commerce	Service
Retail Capability	Product Information	Stock and Order	Customer Service
	Digital Marketing	Pricing	Loyalty and Rewards
	Social Network	Check Out and Payment	Delivery and Post-Sales Service
Overlapping features	Consumer Experience Digitization Personalization		
Omni-channel Touchpoints			

Data Source: Monitor Deloitte Analyses.

Digital supply chain network

In the new retail ecosystem, technological progress will drive the transformation of the entire supply chain system. The traditional linear supply chain will gradually evolve into a dynamic supply chain network, in which each node can achieve interconnection through a digital core. The seamless data connection and circulation will enable each node to make timely adjustments and feedback based on the data so that the entire supply chain system can form a clearer understanding of consumers' needs. It can also make all aspects of the supply chain operate more efficiently and respond more precisely on consumers' needs and thus better meet those needs while improving overall efficiency.

Figure 6 Evolution of the digital supply chain network



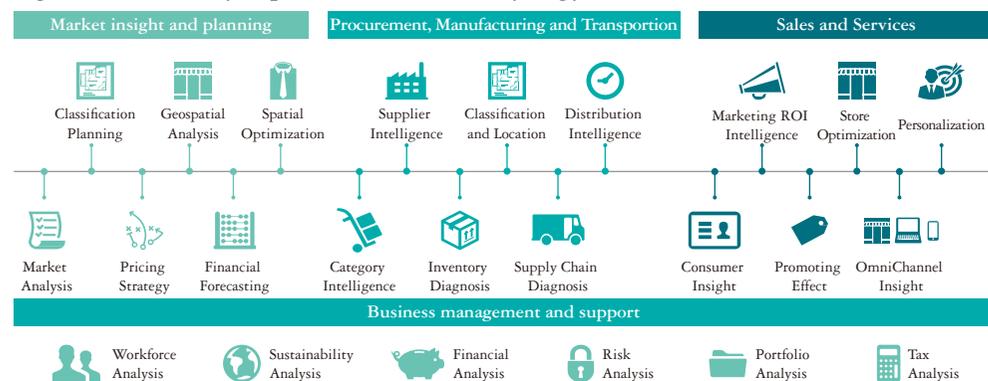
Data Source: Monitor Deloitte Analyses.

Supply chain management is one of the key functions in convenience store companies, since it not only concerns the kind of goods the company produced, but also the set-up of distribution networks, store management and other core daily operations. Therefore, introducing digitalization in supply chain means to integrate every node in an interconnected network, which explains the key role of the supply chain management of convenience store.

Retail analysis

Digitization of the retail business requires not only upgrading and connecting hardware, but also applying proven theory and analytical approaches to optimize every aspect of the retail business, in order to enhance overall business performance and maximize customer value. Based on customer service experience, Deloitte takes a comprehensive approach to go deep into three key areas: market insight, manufacturing, purchasing and distribution, and sales and service.

Figure 7 Retail analysis promotes value chain synergy



Data Source: Monitor Deloitte Analyses.

Deloitte seeks to diverge from the traditional analytical model for the retail industry, that is, analyzing the historical and current status, but resorts to exploring, predicting and simulating the future, then proposing optimal solution based on possible future scenarios. This approach can help convenience store enterprises to become more forward-looking and systematic in the process of digital transformation, and to improve their efficiency and satisfy consumers' needs more accurately, resulting in an enhanced competitiveness.

Who are the Potential Game-Changers in the Industry?

With sustainable growth and recent policy and capital support, the convenience store industry is attracting more and more “outsiders”. E-commerce companies such as Alibaba and Jingdong plan to promote their omni-channel business layout by operating convenience stores, and at the same time, enterprises owning well-known brands such as Wahaha and Laiyifen also hope to expand their direct retail channels via unmanned convenience stores. Hence, new players may become an important force in restructuring the industry. Science and technology has further transformed and diversified the retail industry.

E-commerce companies go offline

In the new retail era, the integration of online and offline sales channels is reshuffling the competitive order in convenience stores industry. In order to manage offline convenience stores better, Alibaba has launched the Lingshoutong Retail Sourcing Platform (“LST Platform”) and

Jingdong has invested in a convenience store smart management system to enable convenience stores to improve their business performance through resource integration and digitization.

The LST Platform launched by Alibaba aims at building an intelligent distribution network in tandem with brand owners and distributors. It will also be sharing the low-cost, high-efficiency warehouses, distribution networks and manpower of the distributor system with the entire FMCG (Fast Moving Consumer Goods) industry. With the LST Platform, brand owners will have a more efficient and accurate coverage of the distribution network while millions of small independent grocery stores will obtain omni-channel services and data support. The marriage of e-commerce companies with offline convenience stores will further integrate online and offline resources :

- **More comprehensive and in-depth consumer coverage.** By obtaining a huge amount of stores resources from providing services to convenience stores, e-commerce companies will achieve a more comprehensive coverage of offline consumers. Shops located in rural regions will help e-commerce companies to expand their local network.
- **Access to high-frequency transaction data and further online and offline integration.** Transactions at convenience stores are of the low-cost high-frequency sort, and may thus generate a large amount of transaction data. By covering convenience stores, e-commerce companies may gain access to this data base and can better integrate online and offline data.
- **Improve the logistics network.** Convenience stores can become offline logistics nodes for e-commerce companies, a crucial element in their endeavor to perfect the logistics network and improve the last-mile customer experience.

New types of retail stores accelerate the proliferation of the offline business layout

Since Hema Xiansheng introduced a new type of retail store in 2016, a group of such stores have swarmed in the market all across China. New stores introduced in 2017 include Tianhong sp@ce, Xinhua Haiwuhui, BBK Xianshiyanyi, Bailian RISO, Zhangyu Shengxian by Meituan, and Jingxuan by CenturyMart. These new retail spaces have become strong market competitors to the traditional retail stores. They owe their success to the Internet, to their omni-channel layout with online and offline coverage, their cross-industry integration of retail and catering, their supply chain integration and the strong support from their sponsors. The emergence of these new retail stores has indicated that the boundary of the retail industry has been blurred.

Table 2 Comparison between convenience stores and new types of retail stores

	Convenience Stores	Hema Xiansheng	Super Species	YH Shenghuo
Category and Model	Fast food, daily service, processed foods, groceries, etc	Retail +Catering +Online +Delivery, features fresh food, higher SKU than convenience store	Retail +Catering +Online, features fresh food, higher SKU than convenience store	Close to convenience store but features fresh food, online +offline
Area	From dozens to more than 100 m ²	4,000+ m ² , Hema Market close to 10,000 m ²	Around 500 m ²	Around 200 m ²

	Convenience Stores	Hema Xiansheng	Super Species	YH Shenghuo
Online Business Percentage	Vary from company to company	Above 50%	Around 10%	-
Operating Model	Affiliate / Self-employed	Self-employed / Associate	Partnership	Partnership
Delivery	Through third parties, uncertainty is high	Fastest delivery within 3 Km can arrive in 30 minutes	Optimizing	Optimizing
Payment Method	Multiple payment methods	Mostly Alipay, supplemented by cash	Multiple payment methods	Multiple payment methods
Number of stores and future plan	Hundreds to thousands of stores, vary from company to company	Plans to open more than 50 stores in the future	Plans to open 25 to 50 stores in 2017	Already owns more than 50 stores

Data Source: Public information, Deloitte Research.

Emergence of multiple service providers

Many types of service providers have emerged in the course of industry transformation. They try to rebuild the existing industry structure by remodeling the supply system, thereby serve as resource integration centers or core technology providers, enhancing the efficiency of the entire industry. The following are two kinds of typical providers.

Unmanned convenience stores

On the second Taobao Maker Festival in July 2017, Alibaba’s unmanned convenience store - “Taocafe” was officially unveiled. Prior to this, in China, many companies had already started to explore the terrain of unmanned convenience stores, including companies like Bingo Box and DeepBlue Technology, which have been put into commercial use. Some large companies like Wahaha had announced future development plans for unmanned convenience stores. Unmanned convenience stores have the advantages of a higher shopping efficiency and lower operating and deployment costs. However, problems persist, especially with respect to the profit model, technology maturity and credit safety.

Integration of operation and management resources

The upgrading of the retail industry has also brought in a number of new retail service providers that focus on technical services and resource integration. They hope to help convenience stores to improve their business performance through optimizing supply chain resource integration, store operations and management.

Table 3 Comparison of retail service platforms

Shandianguo	Pinpianyi
Hopes to build an hourly urban terminal network, capable of supporting the entire city: the trinity of warehousing and distribution capabilities, product structure, and online to offline operation capability. (New basic retail service center)	The small and medium-sized convenience store intelligent procurement platform established through algorithms, aims at sorting out overstock, high procurement costs, and expired merchandise losses.

Huimin	ABLife
Intelligent terminal “Huifutong”, combining business orderings, a comprehensive settlement, online supermarkets, convenience services and other functions as a whole, which may use the background data to review inventory and improve inventory turnover.	Community retail business ecosystem based on B2B (flat supply chain) + CVS (convenience stores) + O2O (in-depth community service). Integrating and connecting online and offline resources, providing better home services for the community.

Data Source: Public information, Deloitte Research.

Although different companies have different focuses, essentially they all work as platforms and vehicles connecting the entire chain. Take Shandianguo for example: integrating traffic, logistics, suppliers, and store management through a one-click access, it has built connections between goods and supply chains, convenience stores, logistics and consumers.

Table 4 Shandianguo Platform

One-click to connect multiple traffic platforms	One-click to connect multiple logistic platforms	One-click to connect multiple quality suppliers	One-click to complete store management
Taobao Ele.me, Baidu Takeout Delivery Meituan	Shunfeng Dianwoda Fengniao imdada	Yiguo Breadtalk Bestore Jiujiuya	CenturyMart Huacheng Supermarket Meiyijia Seashine

Shandianguo

Traffic Management platform	Logistic Management platform	Supple Chain Management platform	Store Management system
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Data Source: Shandianguo.

Although a certain business overlap between the new retail service providers and e-commerce companies exists, due to the fragmentation of the convenience store market in China, new service providers and e-commerce companies are expected to jointly promote the transformation and upgrading of the convenience store industry and to extend it’s frontiers to new areas. They are likely to help the widespread traditional small-scale retailers such as family-run shops to further improve their supply, store and customer management, transforming them into modern convenience stores serving consumers more accurately and efficiently.

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Tianbing Zhang | Deloitte China Partner | Consumer Products / Retail, Wholesale & Distribution Sectors Leader
tbzhang@deloitte.com.cn

Lydia Chen | Deloitte Research Director
lydchen@deloitte.com.cn

Alaric Li | Deloitte Research Consumer Products / Retail, Wholesale & Distribution Sectors Researcher
alarli@deloitte.com.cn

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