



**Next stop for convenience stores**



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# Introduction

I. How long will the golden age of convenience stores last?	2
II. How to transform the convenience store industry?	14
III. What will reshape the convenience store industry?	35



## Next stop for convenience stores

As the convenience store industry continues to show steady growth with sufficient government support and capital investment, it has already become a key focus of the retail market. In order to gain deeper insights into the development of convenience stores, this report analyzes the convenience store industry from three perspectives of future development, transformation and upgrading approaches as well as potential reshaping forces. The key findings include:

- Driven by continued economic growth, emergence of major consumer groups, favourable policies, capital investment and participation of retailers, the convenience store industry has experienced stable growth over the past few years. As these driving factors continue to intensify their influence, the convenience store industry will embrace a new wave of development.
- Digital-centered transformation will pioneer the next stop for the convenience store industry. With consumer needs at the core of the new retail ecosystem, digitalization has become a crucial means to cope with changes and challenges. On the one hand, the commercial nature of convenience stores calls for sustained reaction with and deeper insights into consumers via digital means such as omni-channel approach to optimize and innovate categories and services. On the other hand, the increasingly accelerated digital journey is engendering retail transformation from linear supply chain system to interconnected supply chain network. During the digital transformation, the convenience stores shall leverage digital means to develop an interconnected network binding various links within the supply chain, thus enabling more efficient, accurate and personalized operation along the entire supply to satisfy consumer needs. As talents constitute the fundamental driving force during the course of continued transformation, it is necessary to effectively attract and cultivate digital talents and facilitate existing talent transformation to pave the way for successful corporate transformation.
- Participants from outside the industry may probably become the key force reshaping the convenience store landscape. The convenience store industry, characterized by continued stable development and high-frequency scattered transactions, is experiencing increasingly diversified development with multiple outsiders swarming into it. E-commerce companies striving to empower traditional shops are actively establishing offline retail network by means of resource integration and digitalization, aiming at improving overall operational performance; the accelerated emergence of new-type retailers may possibly pose threats to existing convenience stores, as both are featured by diversified service experience and ever-evolving operating models; the rise of diversified service providers, mainly in forms of unattended convenience stores and service providers, is expected to reshape existing industry structure via resource integration based on technologies, resources and management outputs.

I. How long will the golden age of convenience stores last?

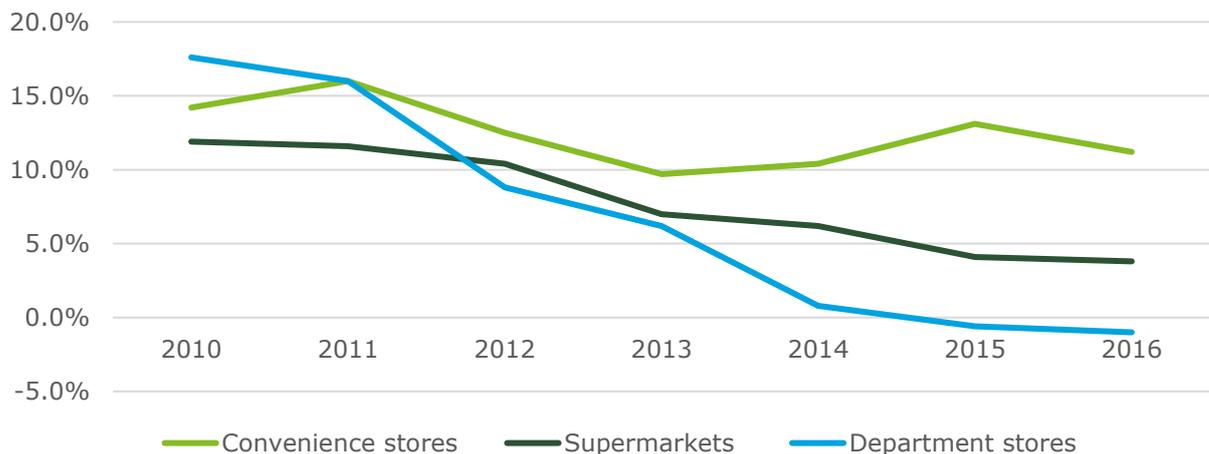
## Next stop for convenience stores

Driven by policy support and capital inflow, the convenience store industry has experienced continued growth against the backdrop of slowdown in domestic brick-and-mortar retailers. In order to gain deeper insights into prospects of the convenience store industry, this report attempts to outline future industry development by making analysis from the perspectives of economic and regional development, competitive landscape, major consumer group, policy, capital and international benchmarking. The findings are listed below.

### 1. Striking performance of convenience stores against overall slowdown in brick-and-mortar retailing

Over the past three years, supermarkets and department stores have witnessed obvious sales drop with continued negative growth in sales of department stores since 2015. Against the backdrop of overall depression, the sales of convenience store industry remained a more than 9% annual growth in the past seven years. According to quarterly convenience stores prosperity index prepared by the Ministry of Commerce, the prosperity index for the first quarter of 2017 was 72.22, far exceeding the threshold of 50, and that figure rose by 1.7 to 73.95 in the second quarter, indicating the confidence among practitioners in continued industry growth.

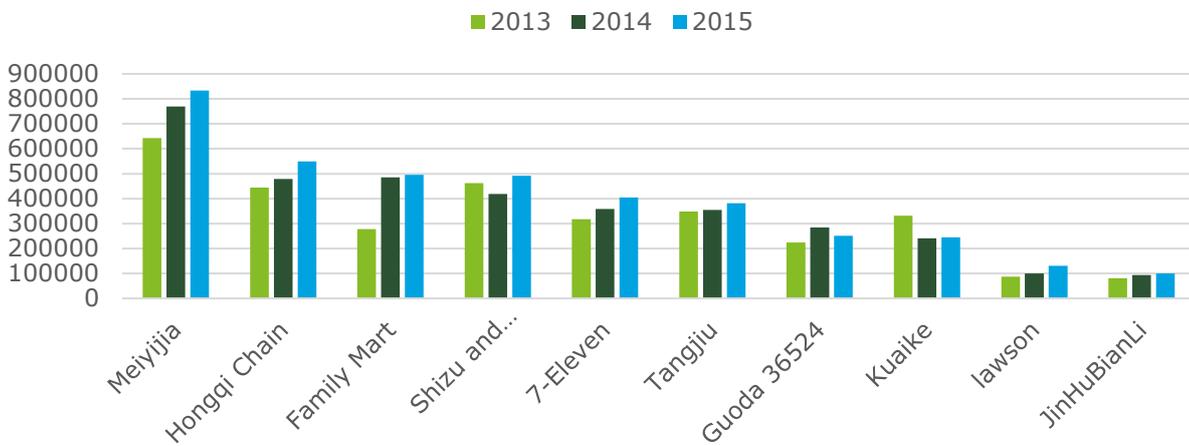
**Figure 1 Y-o-y retail sales growth by format**



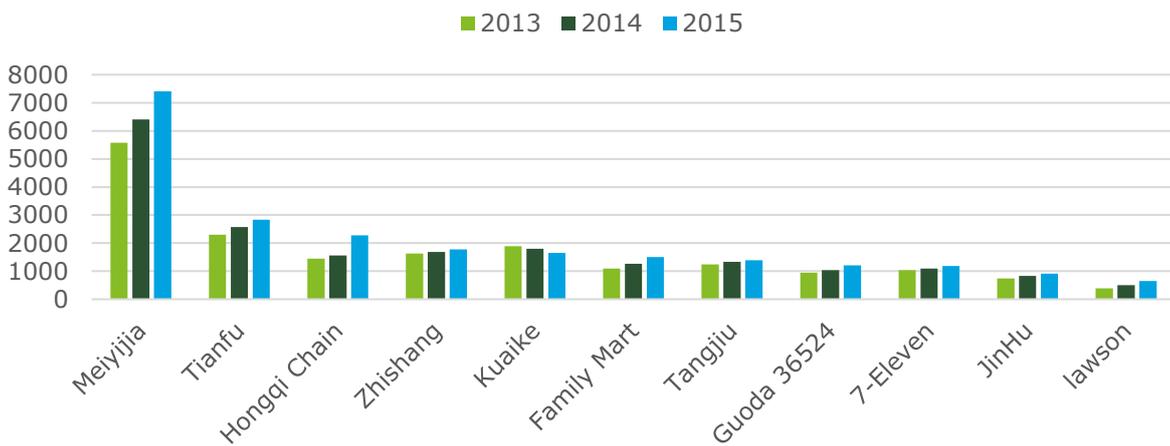
Source: Euromonitor, Deloitte research

According to statistics from China Chain Store & Franchise Association (CCFA) over the past three years, most top 10 convenience stores have witnessed continued growth in sales and store count. Meiyijia, a regional convenience store ranking the first, has experience significant growth in both scale and increase rate, with over ten thousand stores in operation and annual sales reaching RMB10 billion in 2017.

**Figure 2 Sales of top 10 convenience stores (RMB10,000)**



**Figure 3 Store count of top 10 convenience stores**

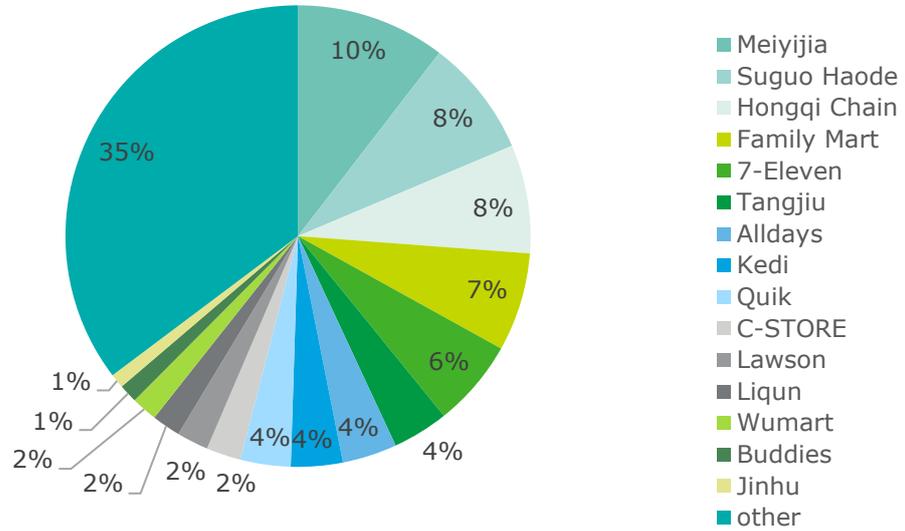


Source: CCFA, Deloitte research

**2. Growth opportunities behind highly fragmented markets**

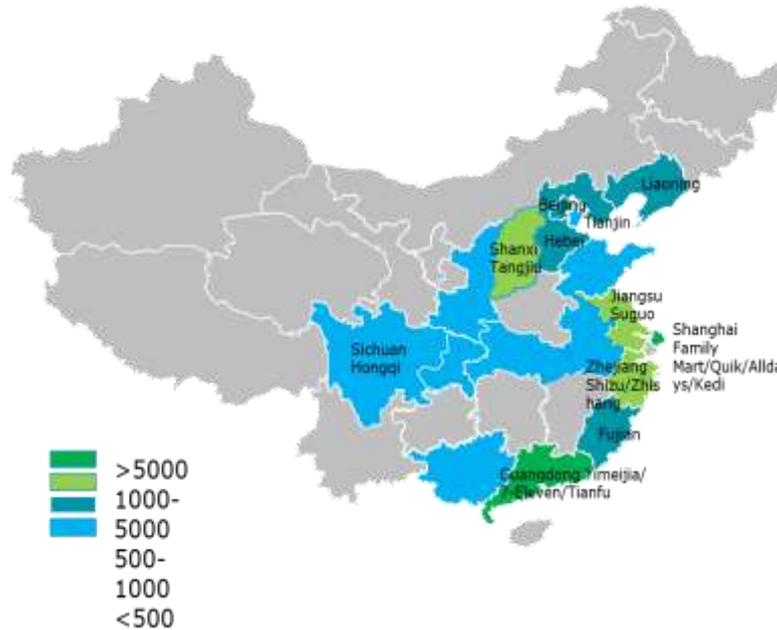
Due to various factors including unbalanced industry and regional economic development, China's vast territory, and cultural differences, China's convenience store industry is featured by low concentration ratio. In terms of market share by sales revenue, Meiyijia, ranking No.1 in sales, only recorded a 10% market share. Meanwhile, the HHI index of top 10 convenience stores is merely 378.6 (HHI below 1000 indicates a competitive market), representing an unconcentrated competitive market. The convenience store industry has also shown obviously unbalanced development in different geographic areas. Most convenience stores have limited their operations by developing and expanding mainly in areas near the provinces and cities of their origin, except Meiyijia, Family Mart, 7-Eleven and Lawson which have establishments across multiple regions. At the same time, it can be seen from the layout of convenience stores in China that only Shanghai and Guangdong have a store count of more than 5,000, while the rest are generally less than 1,000. Unbalanced regional development has created great potential opportunities for expansion. With lower human cost and rentals, second- and third-tier cities may probably become important source of income for convenience stores. Therefore, convenience stores are expected to experience further expansion with continued economic growth and development of consumption habit.

**Figure 3 Market share of Chinese convenience stores by sales revenue in 2016**



Source: Euromonitor, Deloitte research

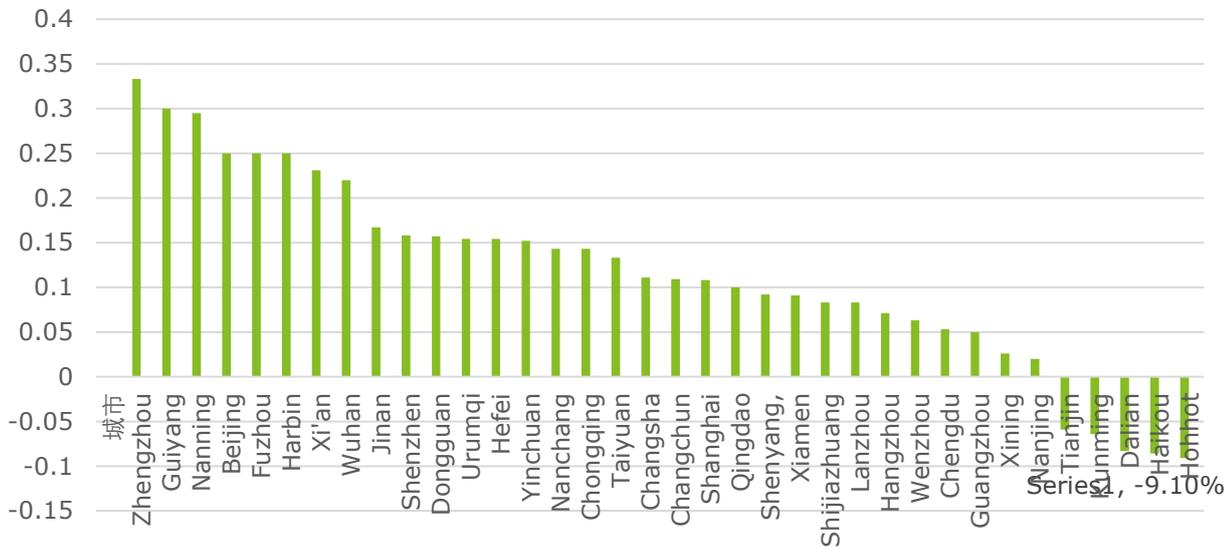
**Figure 4 Layout of convenience stores in Chinese mainland by region**



Source: Kantar Retail, Deloitte research

According to a survey by the Ministry of Commerce and CCFA on 36 large and medium-sized cities, 52.8% of convenience stores have shown a more than 10% increase in store count, with cities characterized by a low density of convenience stores increasing at a faster rate such as Zhengzhou, Guiyang, Nanning, and Beijing, etc., which to some extent indicated the increasing trend in the density of convenience stores.

**Figure 5 Store count increase rate by city in 2016**

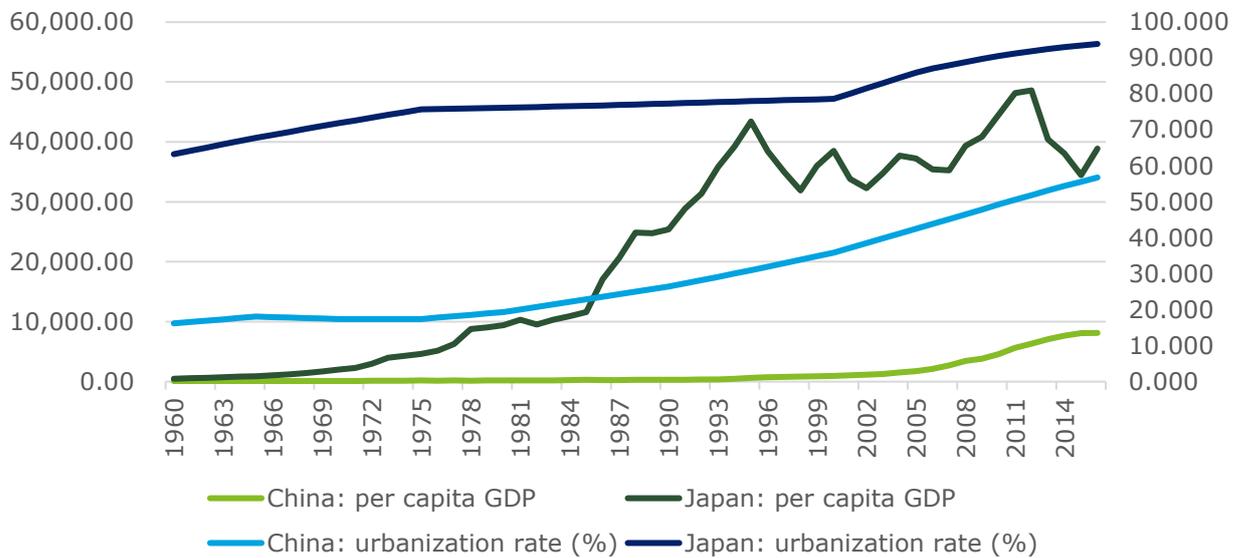


Source: Convenience Stores Prosperity Index Report by Ministry of Commerce, Deloitte research

**3. Evolution of well-established markets revealing the potential of convenience stores**

Based on the evolution of convenience stores in overseas well-established markets and current domestic market, the development of convenience stores is closely related to economic growth and the level of urbanization. According to practices in of foreign countries, the market begins to introduce convenience stores when per capita GDP hits USD3,000. When per capita GDP climbs to USD10,000, the convenience store industry gradually becomes mature with a more intensive competitive landscape. In the 1970s, convenience stores such as 7-Eleven, Lawson and Family Mart began to venture into Japan as the country's per capita GDP reached USD3,000. Later, with continued increase in per capita GDP and level of urbanization, the convenience stores in Japan has experienced sustained stable growth; Similarly, convenience stores like 7-Eleven, Family Mart and OK began to emerge in Taiwan when its per capita GDP exceeded USD3,000 in 1983. Convenience stores in China have developed in a quite similar way with those in Japan and Taiwan at the early stage. With increasing per capita GDP, the first convenience store opened in Chinese Mainland in the 1990s. Around 2005, foreign convenience stores began to swarm into Chinese market, and China has since then recorded a higher per capita GDP than that of Japan in the 1970s (per capita GDP of USD3,000), with a sharp rise in urbanization rate. China's continued rapid development has created great opportunities for the convenience store industry. While China's economic growth is expected to slow down in the foreseeable future, it will remain a modest increase which may also support the development of convenience stores in China.

**Figure 6 Relationship between convenience stores and economic growth in China and Japan** USD

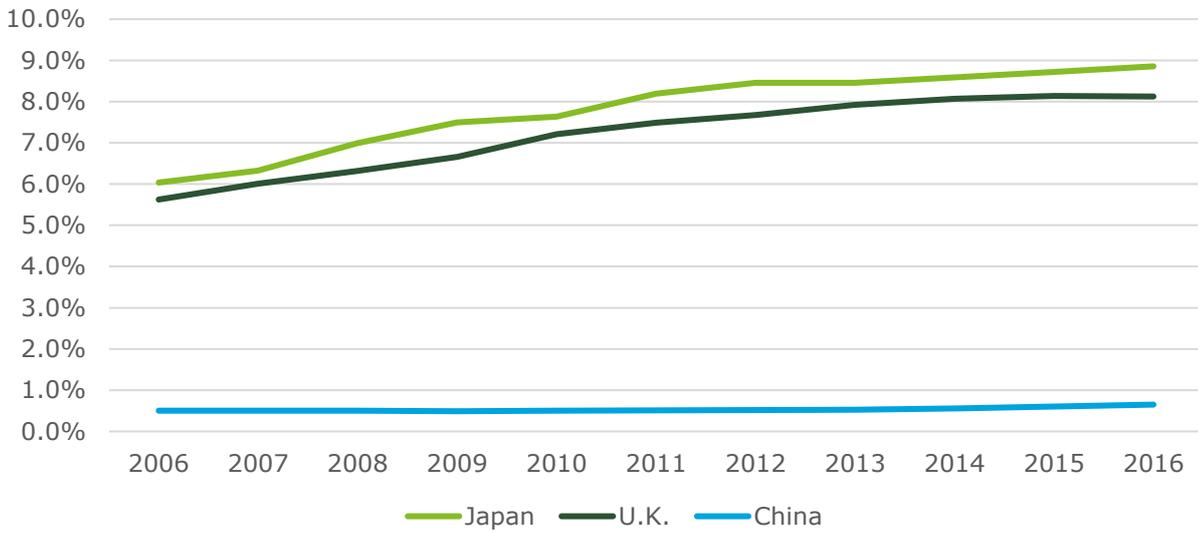


Source: World Bank, Deloitte research

Population density constitutes another key factor contributing to convenience store development. Based on the development of convenience stores in other countries, it can be seen that the higher the population density, the better convenience stores develop. For example, convenience stores have experienced robust development in Japan, U.K. and Taiwan, the population density of which were 348, 255.6 and 650 people per square kilometre respectively in 2016. By contrast, in the United States, due to low population density (35.3 people per square kilometre) and consumption habit, convenience stores failed to become a major retail format. With regard to major cities in China, the population density of top 50 most populated cities was higher than 640 people per square kilometre, far exceeding the average of Japan and U.K., and the population density of China's top 90 cities was also higher than 200 people per square kilometre, thus providing solid population foundation for convenience stores to develop.

Statistics showed that sales of convenience stores in Japan and U.K. took up an increasing proportion in total retail sales year by year from 2006 to 2016. By 2016, sales of convenience stores in Japan represented nearly 9% of the total, up 3% compared with that in 2006. In China, that percentage was lower than 1% despite continued growth since 2014. By benchmarking with the global market, there is still great growth potential for convenience stores in China.

**Figure 7 Percentage of sales of convenience stores in total retail sales**

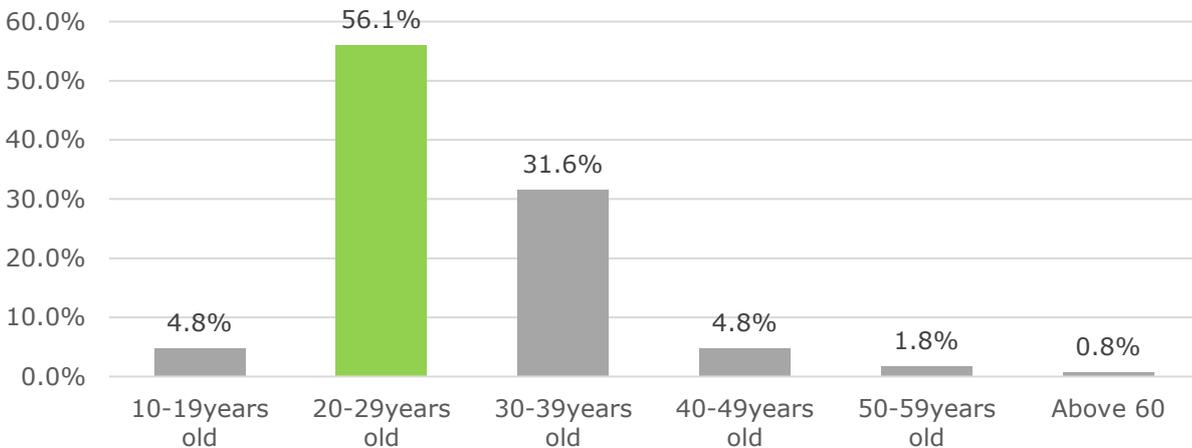


Source: Euromonitor, Deloitte research

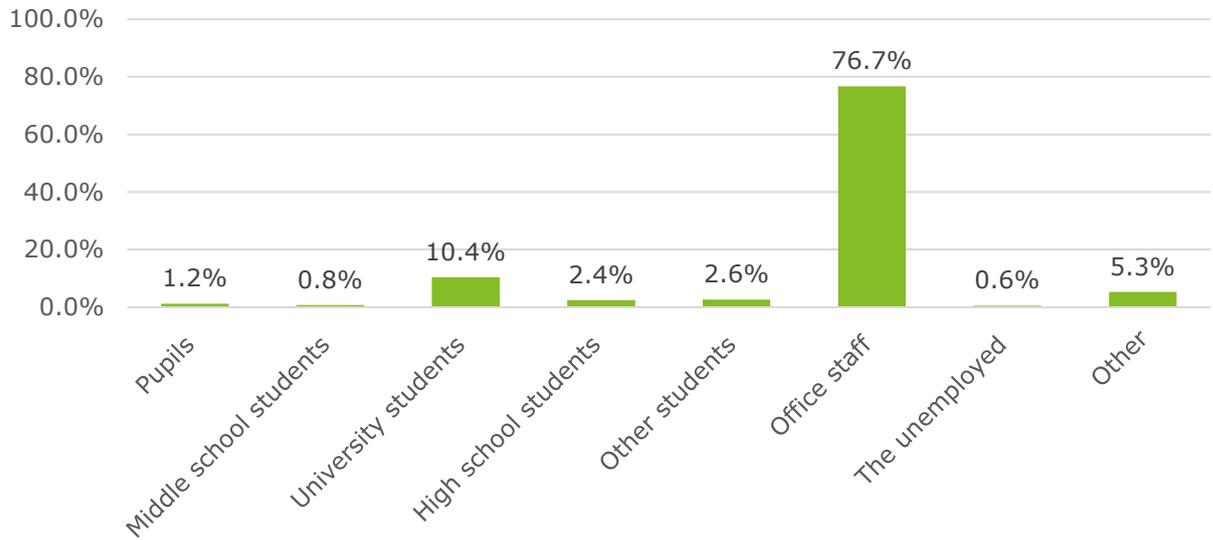
**4. Continuous development of convenience store supported by major consumer groups**

China's rapid economic growth has created more jobs and ensured continued stable income growth for the young generation, thus further stimulating consumption demands of the young generation. Unlike the previous generation, new generation of consumers focus more on convenient, personalized, and high quality shopping experience. According to statistics from Family Mart, the ever expanding new generation of consumers have become the major force in the convenience store market, with post-80s and post-90s consumers accounting for 88.4% of the total; meanwhile, statistics from 7-Eleven also indicate that consumers aged 20 to 40 take up 88% of the total. In terms of consumer groups, office staff comprise the major consumers.

**Figure 8 7-Eleven consumers by age group**



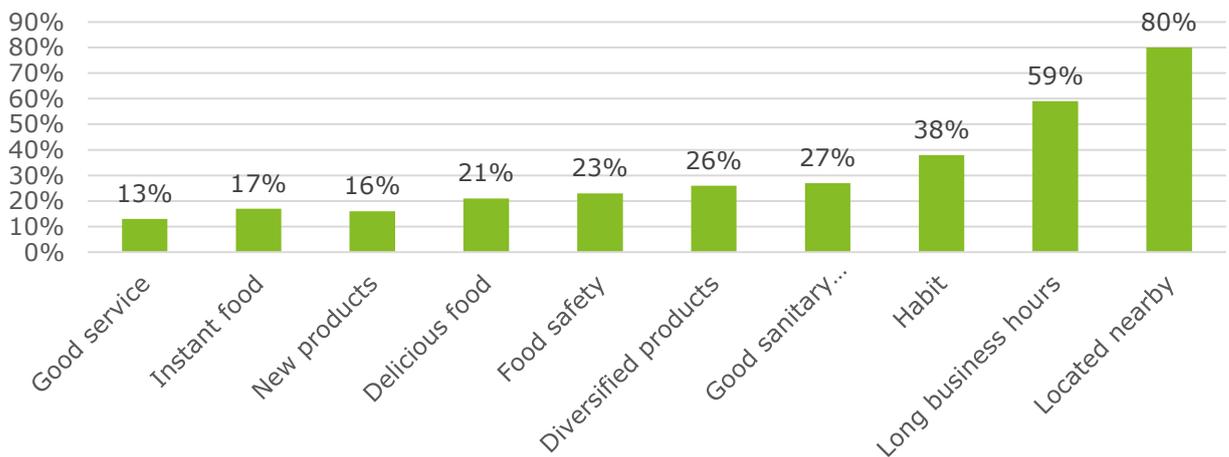
**Figure 9 Consumer groups of 7-Eleven**



Source: 7-Eleven, Deloitte research

Survey on convenience store consumers show that 80% of consumers shop in nearby convenience stores, while 59% shop in those with longer business hours. Therefore, convenience is an essential driver for consumers to shop in convenience stores.

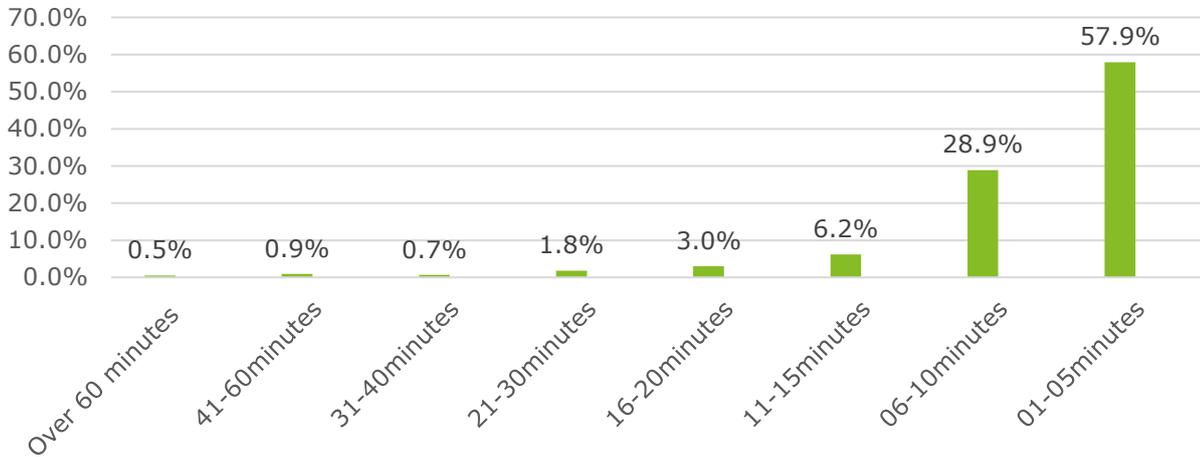
**Figure 10 Reasons why consumers shop in convenience stores**



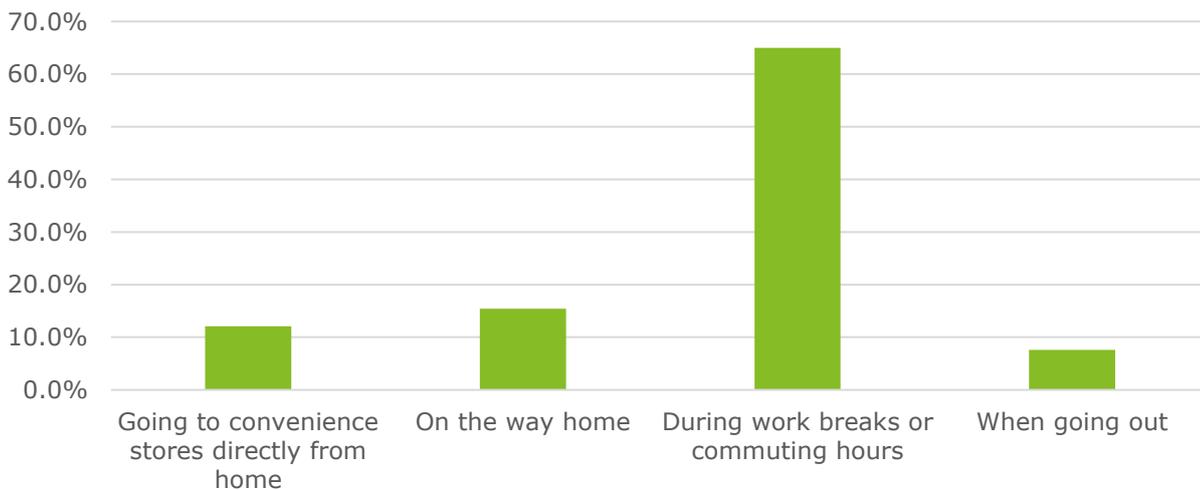
Source: Analysis on the Development of Convenience Stores, Deloitte research

Based on the research on consumer behaviours, convenience stores mainly satisfy the consumption needs of consumers who can arrive within 10 minutes during their work breaks or commuting hours. According to the statistics from 7-Eleven, 86.8% of consumers can find a convenience store within 10 minutes, 65% of consumers shop in convenience stores during work breaks or commuting hours, and only 12.1% of consumers go to convenience stores directly from their homes. Statistics shows that convenience stores satisfy fragmented needs of consumers when providing convenient services, which is unique in the retail market.

**Figure 11 Time spent for finding convenience stores**



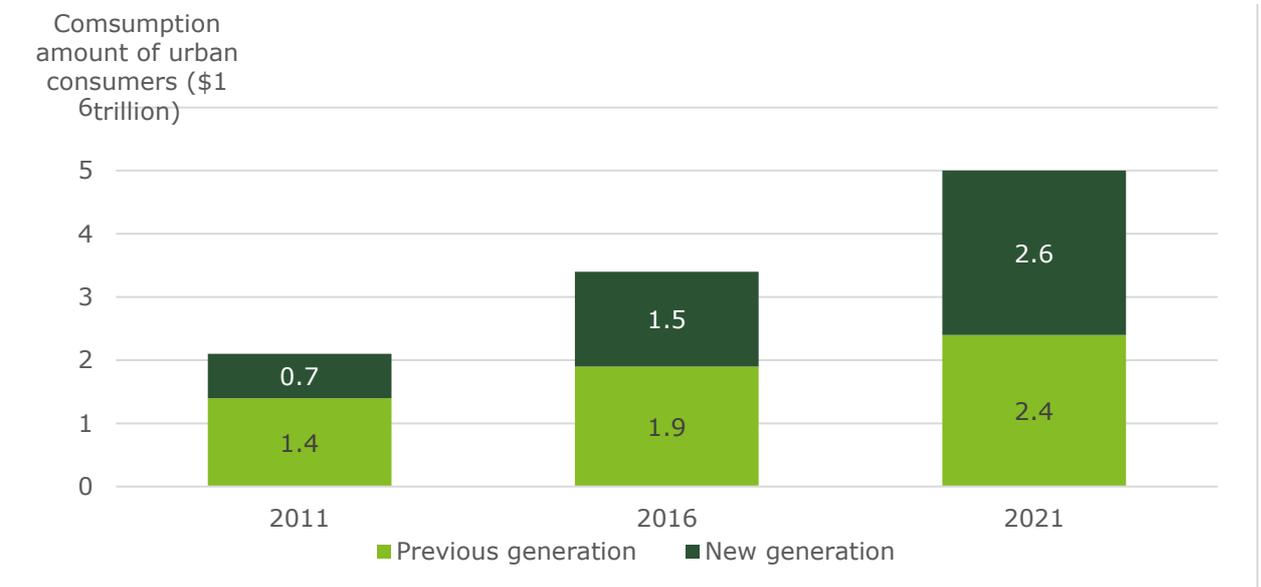
**Figure 12 Situations in which consumers go to convenience stores**



Source: 7-Eleven, Deloitte research

The young generation are the major consumer group of convenience stores, they will have huge consumption potentials in the future. It is predicted that, the consumption of the new generation of consumers (aged 18 to 35) will maintain fast growth. By 2021, the amount of their consumption is expected to hit \$2.6 trillion (exceeding that of the previous generation consumers (above 35)) with 11% of compound growth rate (twice of that of the previous generation consumers over the same period).

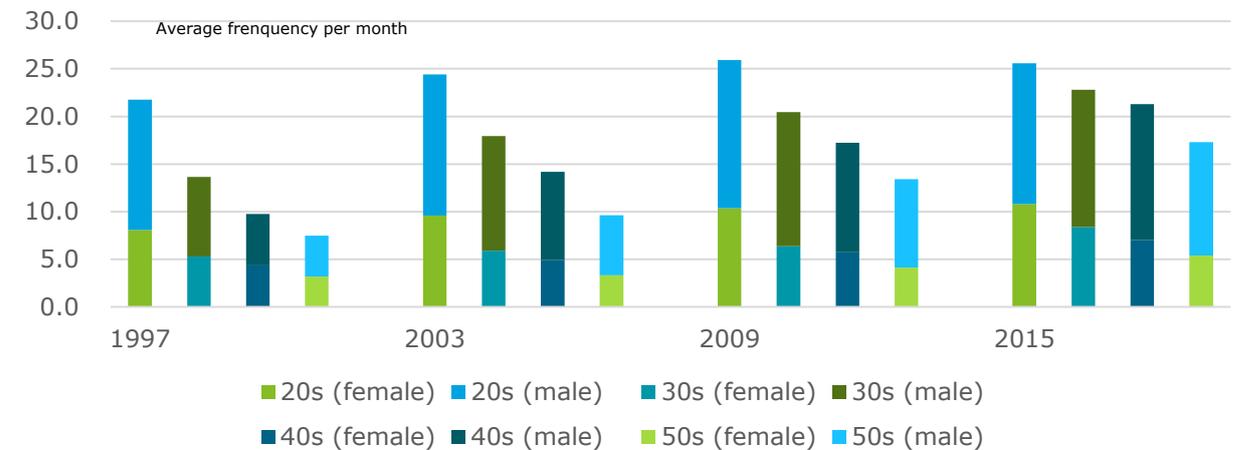
**Figure 13 Consumption amount of young generation consumers**



Source: BCG, Deloitte research

As the major consumer group of convenience stores, the growth of young generation's consumption needs will improve the sales of convenience stores to some degree. In accordance with a survey in Japan, from 1997 to 2015, consumers in their 20s (aged 20 to 29) went to convenience stores most frequently at stable frequency and consumers in their 30s (aged 30 to 39) and 50s (aged 50 to 59) went to convenience stores more and more frequently in several consecutive years, among them, the frequency of consumers in their 40s increased from 9.8 to 21.3. Similar to Japan, the statistics of Family Mart and 7-Eleven in China shows that, young generation have contributed most sales and growth for convenience stores. With the increase of incomes and the maturity of consumption habit, more consumers will go to convenience stores, thus improving the sales of convenience stores.

**Figure 14 Changes in the frequency of consumers shopping in convenience stores by gender and age**



Source: NRI, Deloitte research

## 5. Development of convenience stores supported by policies

Policy support currently plays a very important role in the development of convenience store industry. Looking from the national level, in 2015, the General Office of the State Council published the first comprehensive and systemic policy document for promoting life services — Guidance on Accelerating the Development of Life Services and Promoting the Upgrade of Consumption Structure, which covers consumption upgrade and the way to improve the scale, quality, and effectiveness of life services. At local level, Southern China has greater policy support on convenience stores than Northern China, but recently, some favourable policies also have been issued by some northern cities. For example, Beijing recently has published a series of policies on regulating convenience store chain industry, which will promote the standardized development of chain convenience stores in Beijing.

**Table 1 Policies relating to convenience stores (incomplete)**

Time	Region	Policy	Contents relating to convenience stores
2014	Shanghai	Opinions of Shanghai Municipal Government on Promoting Life Services	Establish community business system, improve convenient and integrated functions, and appropriately develop supermarkets, convenience stores, barber and beauty shops, express delivery, speciality stores
2014	Tianjin	Establishing one chain store in each village in rural areas	By 2017, Tianjin will basically achieve the target of establishing one store in each village by spending RMB17.5 million to establish 1,343 chain convenience stores at village level.
2015	Nationwide	Opinions of the General Office of the State Council on Accelerating the Development of Life Services and Promoting Consumption Structure Upgrade	Vigorously develop community business, establish convenience stores at community level, and regulate and expand handy services for the public such as proxy charging and receiving services
2015	Ningbo	Detailed Rules on Encouraging the Development of Business Industry for People's Livelihood in 2015	Encourage the establishment of chain convenience stores and grant rewards as much as RMB20,000 according to the scale
2015	Nanchang	Implementation Plan on Accelerating the Construction of Chain Convenience Stores at Community Level	From 2015 to 2016, establish or transform 300 to 500 chain convenience stores at community level as the Implementation Plan requires in urban areas (Development Area and New Area)
2016	Beijing	Industry Norms of Chain Convenience Store Industry in Beijing (trial)	Beijing will set a series of standard and demonstrative convenience stores, enhance capital and policy support, and help convenience stores to provide more services. Later, it will publish policies to support convenience stores in providing catering services.

Source: Public information collation, Deloitte research

## 6. Rapid development of convenience stores driven by capital

Due to stable performance, frequent consumption, and convenient service experience, the industry of convenience store has attracted increasing attention in recent years, which reached its peak in 2017. Under such background, inflow of large amount of capital has become an important driving force in promoting the development of convenience store industry in the short run. Enterprises having received capital investments can be divided into three categories: innovative convenience store, unattended convenience store, and service provider. Innovative convenience stores are represented by Bianlifeng, which has received several hundreds of millions of financing; Bingobox and Xiaomai are typical examples of unattended convenience store, which have received over one hundred million of financing in this May and July respectively; and investing service providers also becomes an important trend. They provide technology sources, supply chain resources, management sources to numerous small retail sales merchants to improve the overall efficiency of the whole platform. Moreover, huge store basis also gives the model of service provider more possibilities.

**Table 2 Financing of domestic convenience stores and relevant enterprises (incomplete statistics)**

Brand	Time	Financing details	Business model
Xiaomai	July 2017	RMB125 million in series A financing	Unattended convenience store
www.pingogo.cn	April 2017 and July 2017	Millions of proceeds in angel round financing and tens of millions of proceeds in series B financing	B2B service provider
Huoquanquan	July 2017	\$10 million in Pre-A financing	B2B service provider
F5 Future Store	June 2017	RMB30 million in A+ round financing	Unattended convenience store
Bingobox	May 2017	Over one hundred million in series A financing	Unattended convenience store
Today	May 2017	RMB30 million in series A+ financing	Convenience store
I Believe	March 2017	RMB200 million in series B financing	B2B service provider
Bianlifeng	February 2017	Several millions in series A financing	Convenience store
www.huimin.cn	September 2016	RMB1.3 billion in series B financing	B2B service provider

Source: Public information collation, Deloitte research

Based on the above analysis, Deloitte thinks that convenience stores can satisfy consumers' requirement of convenience. Besides, with the rise of the new generation of consumers, the industry of convenience stores will maintain relatively stable growth in the foreseeable future, improve industry maturity rapidly under capital and policy support, and experience fiercer competition.

## II. How to transform the convenience store industry?

As Chinese retail industry is confronted with numerous development challenges due to changed consumption preference, disruption of e-commerce, and outdated operating models, a new round of transformation and upgrade is brewing. Meanwhile, after years of fast growth, online retailing market has slowed down its pace year by year and become mature gradually. To acquire broader development space, E-commerce enterprises are actively developing off-line businesses and promoting the transformation of brick-and-mortar retailing by exporting technologies and operation philosophies. Under such trend, Chinese convenience store industry will not only experience enterprise integration, but also be impacted by multiple parties, including enterprises in other industry formats, e-commerce enterprises, start-up enterprises, etc. In order to achieve continuous growth under increasingly complicated and competitive market environment, convenience store enterprises need to take consumer demands as the core, integrate and improve each daily operation links by fully utilizing digital methods, and keep competitiveness by continuously offering high-quality and convenient services.

### **1. Optimization of product categories and services to build core competitiveness**

The nature of retailing is continuously satisfying consumers' changing demands. For convenience store enterprises, they shall concern questions like what kind of product and service shall be provided and how to satisfy consumer demands. In order to maintain continuous growth in increasingly competitive market, convenience store enterprises shall focus on optimizing categories and services constantly.

#### **Category optimization**

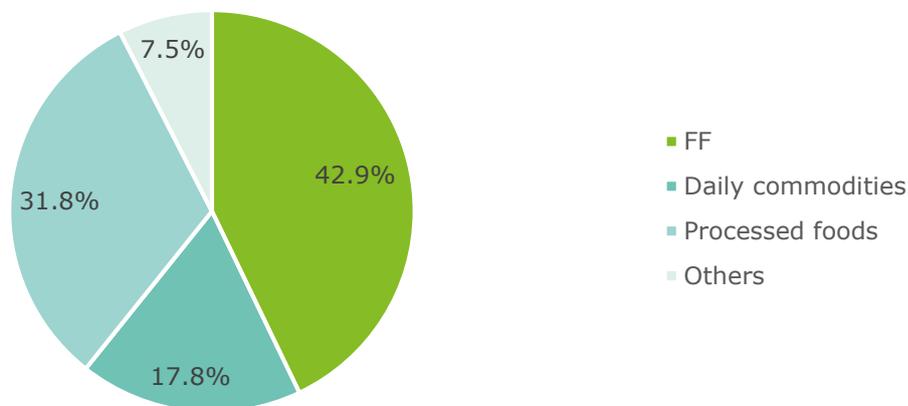
Commodities and services are the major medium to connect convenience store enterprises with consumers. Consumers' opinions on convenience store enterprises directly depend on whether commodities and services can effectively satisfy consumers' demands. Therefore, leading convenience store enterprises in the international market make continuous investments into commodities and services and take continuous optimization and upgrade of category as the core content of their strategies for nearly a decade. To deal with consumers' demands, they have taken many important measures including branding, expansion into catering sector, and deep engagement in production.

#### **Enhancement of differentiated competitiveness with catering services**

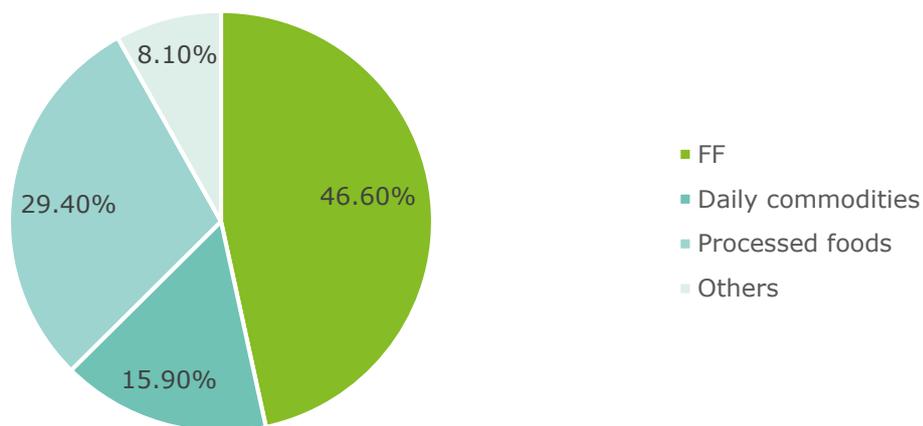
Adding fresh food into the current product category is an important measure and optimization direction for many foreign-funded convenience stores. Convenience store enterprises hope to enhance their advantages over their competitors by providing diversified food choices and build unique images with typical food commodities and services, so as to improve the loyalty of consumers.

As 7-Eleven's statistics in China shows, most of its sales and gross profits come from FF (Fast Food) commodities, which contribute 42.9% of sales and 46.6% of gross profits. While domestic convenience stores mainly provide processed foods and non-food grocery goods, and seldom provide FF commodities. Based on the operation results of foreign-funded convenience stores, represented by 7-Eleven, FF commodities can meet consumers' demands for fast food and make great contribution to the sales and gross profits of convenience stores.

**Figure 16 Sales proportion of different commodities of 7-Eleven**



**Figure 17 Gross profits proportion of commodities of 7-Eleven**

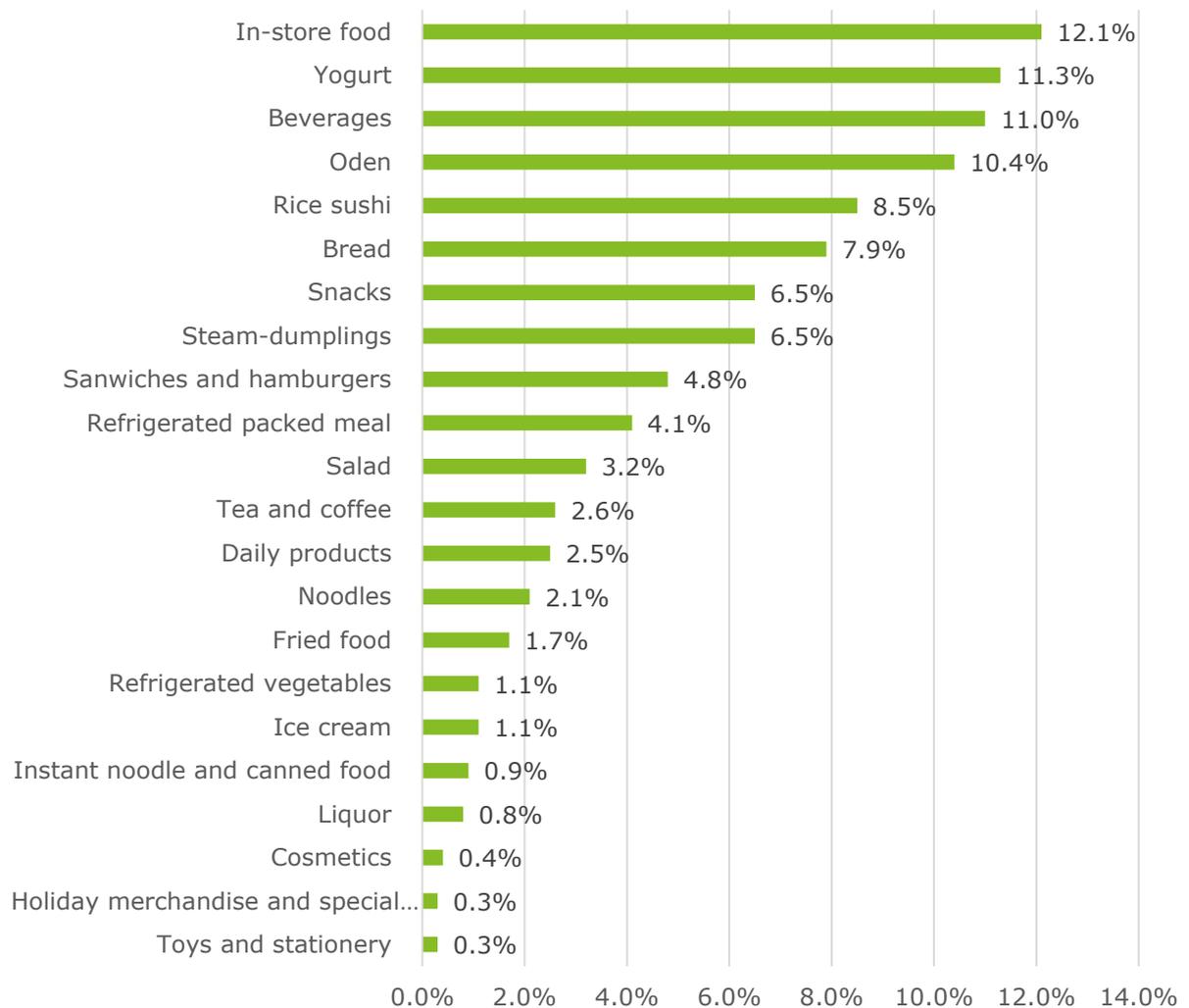


Source: 7-Eleven, Deloitte research

Note: FF (Fast Food)

According to a survey on Chinese consumer behaviours made by 7-Eleven, in-store food, dairy products, beverages, oden, and rice sushi are the top five most-wanted products for consumers. Among them, except for dairy products and beverages, other categories are fast food. Foreign-funded convenience stores such as 7-Eleven have built unique category and service images among consumers by effectively meeting consumers' catering demands and which has become an important factor that driving consumers to make repeat purchases.

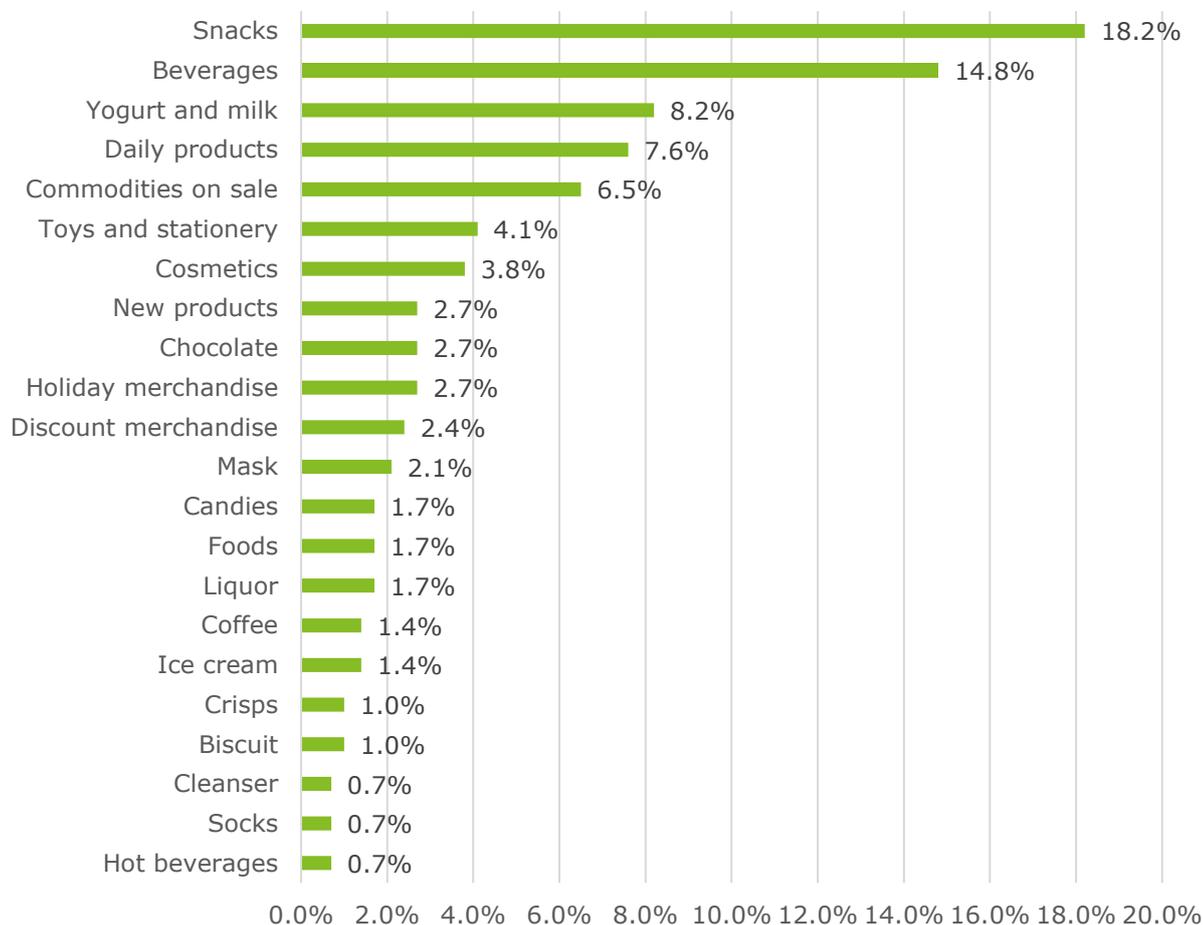
**Figure 15 Ranking of most-wanted commodities (survey on 7-Eleven consumers)**



Source: 7-Eleven China, Deloitte research

Foods and beverages have contributed most sales growth for convenience stores, and meanwhile promoted the sales of other categories of products to some degree. Based on the results of 7-Eleven's survey on Chinese consumers, snacks, beverages, and dairy products are the top three categories that consumers will choose after purchasing other products. According to the survey on the most-wanted commodities, consumers will be more likely to buy snacks and beverages after purchasing fast foods.

**Figure 16 Ranking of commodities that consumers may buy after purchasing other products (survey on 7-Eleven consumers)**

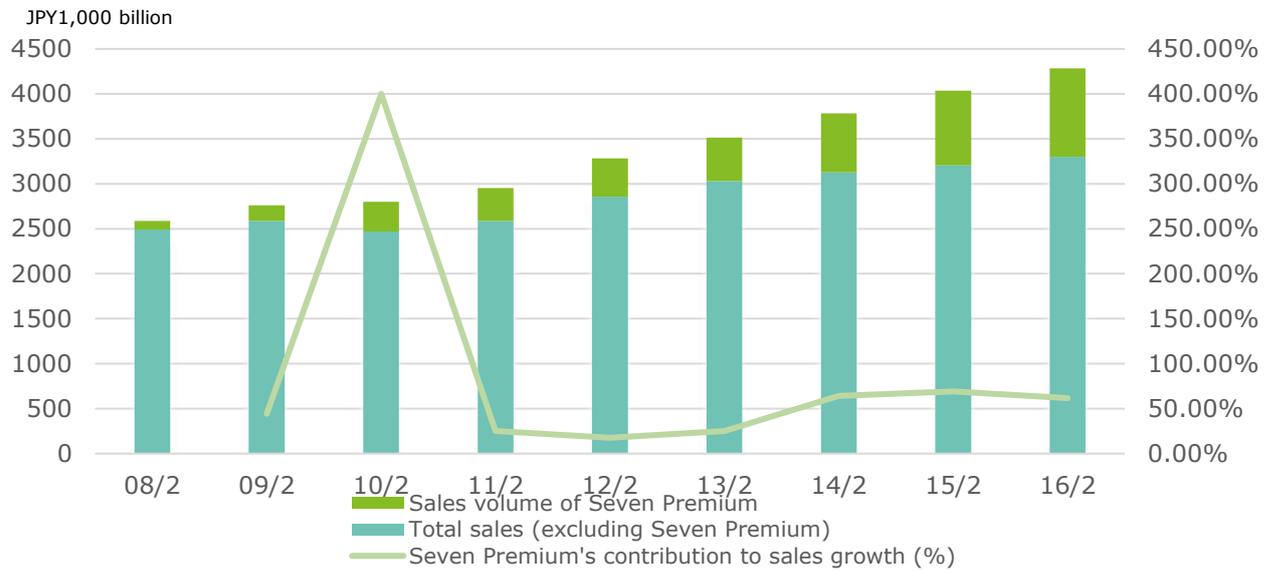


Source: 7-Eleven, Deloitte research

## 2. Branding

Branding is another important development direction world-leading convenience stores and other large retail enterprises are moving towards. Proprietary brand allows convenience stores to convey distinctive quality and value idea with high-quality and differentiated goods and better meet the needs of different customers. Take 7-Eleven, the representative of proprietary brand development in the industry, as an example. By the end of February 2016, Seven Premium, subordinate to Seven Eleven Japan (SEJ) has achieved a sales volume of JPY 1,000 billion, which makes it the largest proprietary band in today's Japan. Adhering to the concept of providing high-quality goods with reasonable prices, Seven Premium has shown a continuous two-digit growth in recent decade. For three consecutive financial years starting from FY2014, Seven Premium has contributed more than 60% to the sales growth of SEJ, being the main driver of the growth.

**Figure 20 SEJ's sales structure**



Source: SEJ annual report, Deloitte research

To accurately meet the needs of different customers, SEJ released higher-quality Premium Gold and detail-and material-oriented Seven Lifestyle in succession. With such effort, SEJ can not only meet diversified customer demand but enhance customer stickiness and differentiation advantage in competition.

**Figure 21 Positioning of SEJ's proprietary brand**



Source: SEJ annual report, Deloitte research

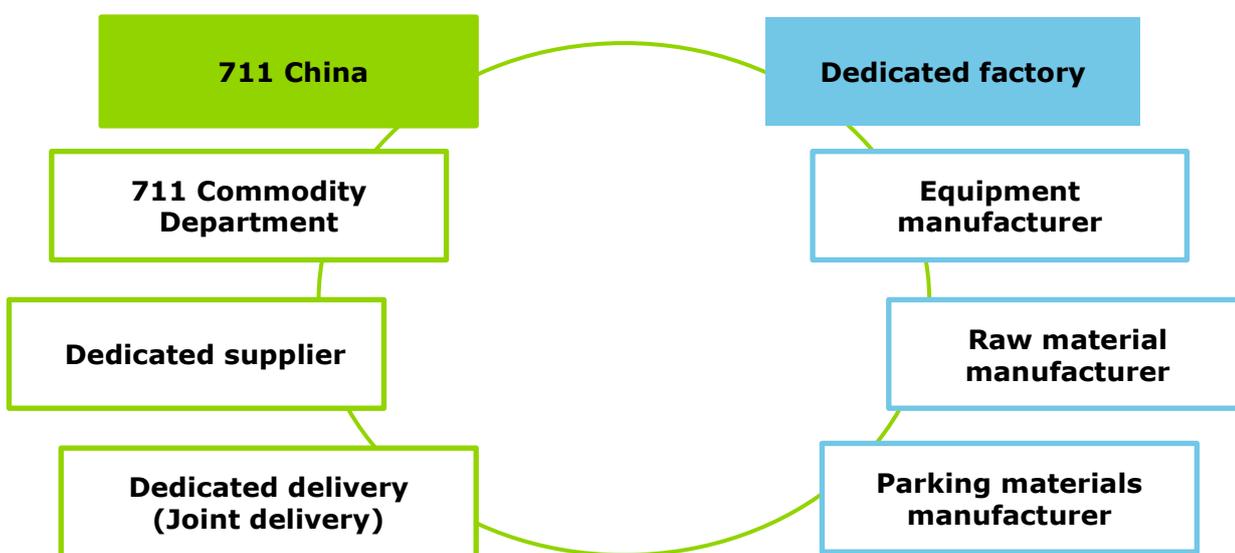
Lawson is in the same situation with SEJ. Lawson released its 1000-day Plan in its 2016 annual report which is to establish the business model of manufacturing retailer and build positive interaction with each link of production and distribution. Recently, nearly 1/3 of goods in Lawson stores are its original products and its subsidiary, SCI, is responsible for the procurement of raw materials, which would help to guarantee quality and enable Lawson to engage in production optimization more directly. In the future, Lawson will establish a complete production line for its own brand Lawson Select to upgrade the quality and value of each category. 7-Eleven and Lawson attaching great importance to original products and proprietary brand not only brings sales increase and customer gathering but also plays a crucial role in their long-term development and diversified competition.

### 3. Deep involvement in production

The development of proprietary brand and fast food is indispensable from deep involvement in production. Take Lawson as an example. It has mentioned supply chain integration more than one time in its manufacturing retailer planning. By enhancing cooperation with suppliers continuously, Lawson hopes to get more involved in production, so as to guarantee product quality and increase operating efficiency of the whole production system.

7-Eleven has gone far in the aspect, which is evidenced by that it chooses own brand manufacturing to integrate and optimize supply chain more completely. The data indicates dedicated factory has accounted for over 92% in manufacturing plants. With the advantage of self-owned factory, 7-Eleven establishes a commodity development system involving suppliers, which connects each department and node in production link (e.g. Commodity Department, logistics, raw materials, suppliers, etc.), forming a system featuring highly-effective operation.

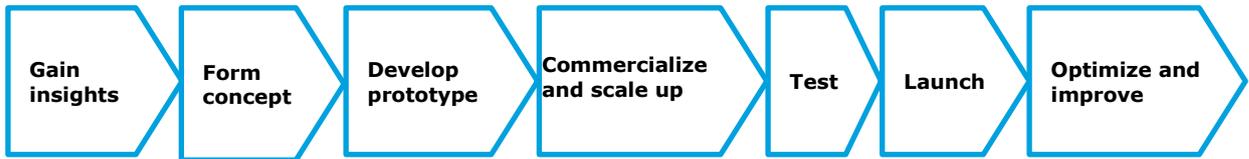
**Figure 22 Joint development system with dedicated factory**



Source: 7-Eleven, Deloitte research

With such a development system, 7-Eleven is able to build a market demand-oriented development system where Commodity Development Department works with suppliers to conduct joint development as well as Commodity Department closely collaborates with suppliers to enable products be more tune with customer demand meanwhile making continuous improvement based on market situations faster. It is said that one month after the introduction of improved sandwich produced by Beijing Wangyang Food Co., Ltd. (7-Eleven's self-owned factory in Beijing), daily sales of sandwich-related goods in per 7-Eleven store in Beijing doubled from 50 to 100 and is expected to grow continuously as time goes on. Self-owned baking formula and self-produced stuffing are the main forces driving the sales increase of such product.

Figure 23 Development process



Source: Deloitte research

Deep engagement in production and establishment of community of interests with suppliers would assist enterprises to better control the quality of category and goods and better manage cost and distribution. Besides, due to establishment of community of interests, suppliers are more motivated to conduct commodity production and optimization so as to work together with enterprises for the improvement of whole value chain.

### Business format innovation and store optimization

Convenience stores, main sites where customers purchase goods and obtain services, are the core carriers connecting customers and commodity service. Consequently, business format innovation and store optimization are other important paths enterprises need to explore.

### Store upgrading and renovation

Upgrading of existing stores would be beneficial for stores to make a more reasonable use of store space and employ new equipment to improve operation efficiency and customer experience. According to Lawson's 1000-day plan, it will increase the number of stores by 10% to 3,500 to better meet the diversified customer demand. It also plans to invest JPY5 billion to upgrade the in-store fixed equipment for store capacity expansion so that all its 5,000 stores in Japan will make supply of goods. Meanwhile, to increase about 25% of production efficiency, Lawson intends to upgrade store system and make investments in replacement of operation terminal, semi-automated ordering system and paperless work, etc. Continuous store optimization and improvement allows convenience stores to keep competitive.

### Multiple business formats

To offer customers rich choices of goods and enhance shopping experience, convenience stores start to focus on innovative attempts on multiple business formats. For example, Lawson released a number of new business formats including Natural Lawson, Lawson 100 and others, among which Natural Lawson mainly sells makeup and health goods, offering customers a more "beautiful, healthy, and comfortable" lifestyle; Lawson 100 where all goods are priced at 100-yen, mainly sells various types of fresh fruits and vegetables and small packages of goods to the old and small family, aiming to provide an economical, easy and comfortable shopping environment to customers.

7-Eleven launches a more disruptive one, which is to deploy mobile vending machines in specific regions to meet specific customer demand. It is expected that 7-Eleven will deploy one mobile vending machine in each prefecture (46 prefectures in total except Okinawa) as of February 2019. In some regions, commercial facilities in previous residential areas have been moved away due to population decline and serious aging problems, local people have to drive a long way to go shopping. Thus, 7-Eleven put forward such plan to help the old living in remote areas to buy daily necessities, such as common drugs and food.

Such measures show that convenience stores are considering regaining the commercial nature. Responding to more segmented demand as well as conducting targeted business format reconstruction and innovation would help convenience stores reach more customers.

### Integration of more diversified services

As a regional customer portal, convenience stores are possible to centre on geographic regions to expand diversified business. Lawson is committed to be the fourth largest infrastructure in Japan communities with its diversified services. To reach such goal, it cooperates with local health

management enterprises to set up a new comprehensive convenience store where a special window is built to provide health consultation to the old. Family Mart is also cooperating with drugstores to enrich its pharmaceutical products and provide simple medical service to the old. Chinese convenience stores could draw lessons from such cases. Convenience stores, as an important portal for community customers, stands a chance to offer more diversified services to meet different demands, so as to form a comprehensive service system

#### 4. Reshaping the value chain of convenience stores via digitalization

According to the research of Deloitte Digital, market trend and consumer trend in retail market and unique digital environment in China are driving the transformation of its retail industry.

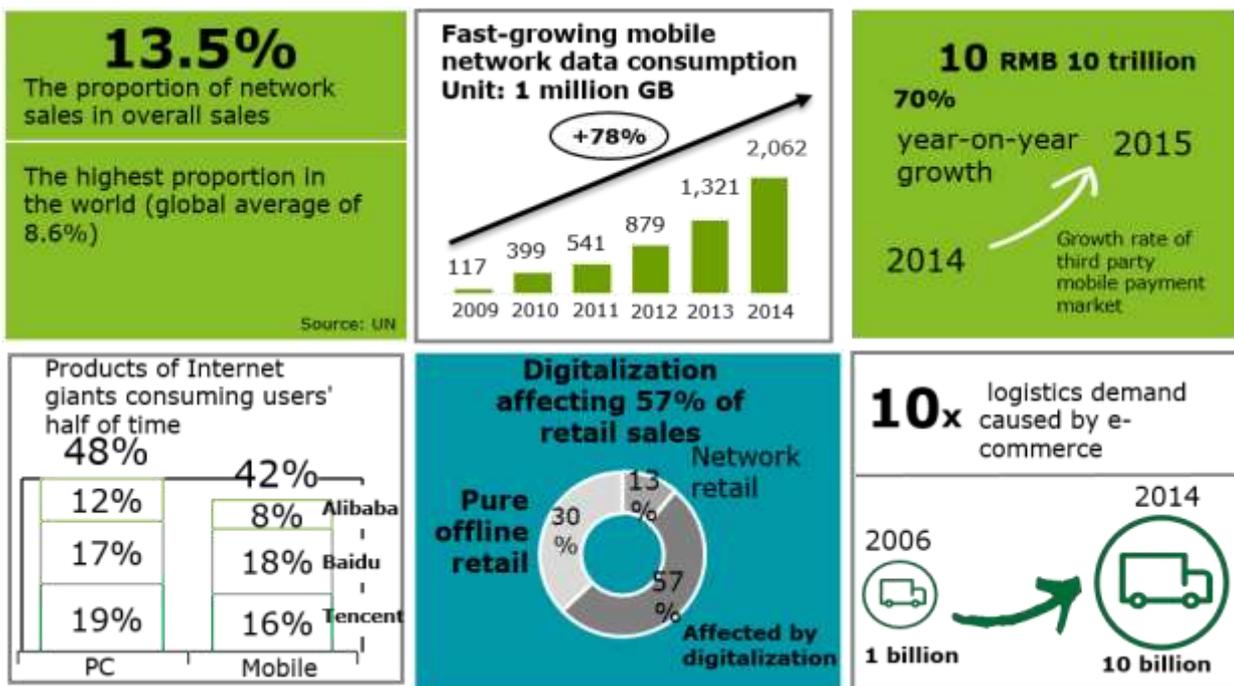
**Figure 24 New ecosystem of China's retail industry**



Source: Deloitte Digital

China owns a unique digital environment where the continuous deepening of digitalization has made a profound impact on many aspects of retail industry. Statistics shows mobile network data consumption, third-party mobile payment and logistics have grown a lot in past years; the proportion of e-retailing in overall retail reaches the highest level globally. Taken together, 57% of retail sales in China's retail market has been affected by digitalization. In such a trend, retail enterprises' capability in digitalization become a significant factor in winning future success.

**Figure 25 Unique digital environment of China**

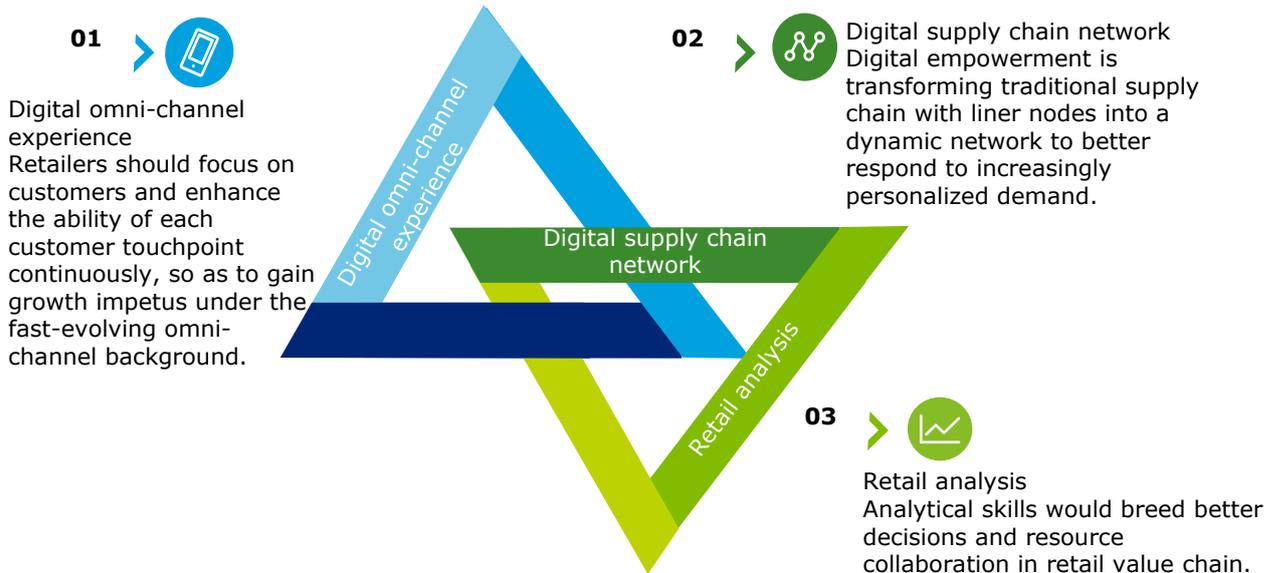


Source: Deloitte Digital

## Next stop for convenience stores

Based on changes in retail industry and the unique digital environment of China, Deloitte has summarized three core dimensions necessary for the success in new market environment—digital omni-channel, digital supply chain network and retail analysis, which would realize the optimization and collaboration of value chain by strengthening consumer touchpoints, integrating and optimizing supply chain digitally and adopting systematic retail analysis method.

**Figure 26 Deloitte's three dimensions for retail transformation**



Source: Deloitte Digital

According to Deloitte's research to digitalization degree of convenience stores, their digitalization degree varies. Foreign convenience stores start early in information system building and digital transformation, however, domestic convenience stores lag behind in the course of digitalization, subject to further optimization. For the digitalization development issues, Deloitte makes following analysis from three dimensions—omni-channel, supply chain and analysis— based on the development status of convenience stores.

### Digital omni-channel experience

Customers have become the centre of new retail ecosystem, thus, retailers are required to build seamless and ceaseless connection with them and offer them optimal shopping experience via omniscient shopping scenes and interactive access, continuously improving capabilities in core issues.

One of Deloitte's survey to consumer behaviour suggests that digital carriers lead to the generation of 85% of customer request. Before making purchase, website information, social network, user comments, etc. are the important influencing factors; after the purchase, nearly half of the consumers hope to get continuous service online. Digitalization has penetrated into every aspect of consumer requests, enabling omni-channel to be one of the critical path for enterprise development.

**Figure 27 Interaction with digital carriers in each stage of consumption**

Consumption stage



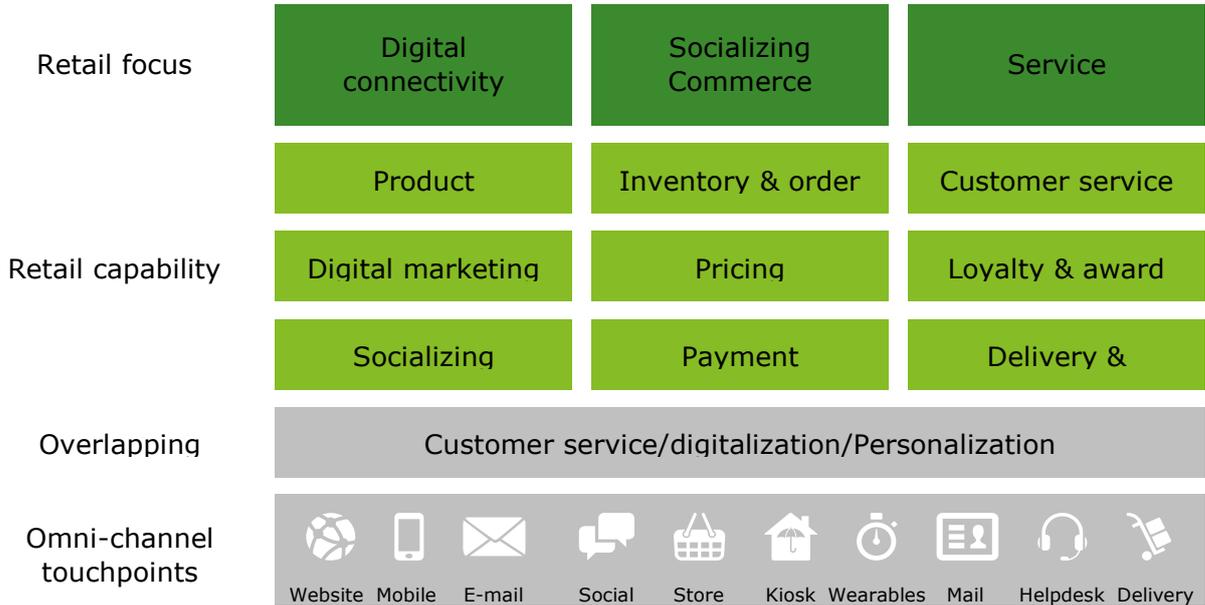
Demand generation	Browsing/searching	Selection/verification	Purchase	Return & exchange/service
<p>53% of consumers choose to use search engine</p> <p>38% of consumers obtain product information via social media.</p>	<p>55% of consumers use third-party commodity comparison websites to conduct product search and investigation</p> <p>54% of consumers would browse official websites before going to the physical store.</p> <p>36% of consumers would obtain feedback via social network site.</p>	<p>50% of consumers obtain product recommendations from friends and relatives via social media.</p> <p>49% of consumers would read online product evaluation in the stage.</p>	<p>41% of consumers choose to make an order online, then get the product by home delivery or picking up in a store</p>	<p>48% of consumers hope to apply return or refund via smart phone or desktop/laptop.</p>

Source: Deloitte Navigating the New Digital Divide

For the current consumer trend and digital environment in China, Deloitte thinks enterprises should focus on digital medium, commerce and service to improve corresponding retail ability in the establishment of omni-channel.

- **Digital connectivity.** For convenience stores, an important objective of digitalization transformation is to better serve customers and build a medium for interconnectivity with customers, so as to convey their product service information, brand image and concept and culture input related to socializing and lifestyle.
- **Commerce.** Another aspect of omni-channel is digitalization of consumer behaviour and data-driven commerce management. Consumer data obtained by multiple means like digital payment and online and offline consumer interaction can be used as real-time feedback to guide product development, order and inventory management, which would enable more precise and effective enterprise operation and store management as well as cost decline and efficiency increase.
- **Service.** Online & offline integrated service is the third aspect in the digitalization transformation of convenience stores. They could make use of member management and service system in omni-channel to conduct member operation actively in the provision of service, so as to offer more diversified and personalized products and services for members, continuously improving member value and stickiness.

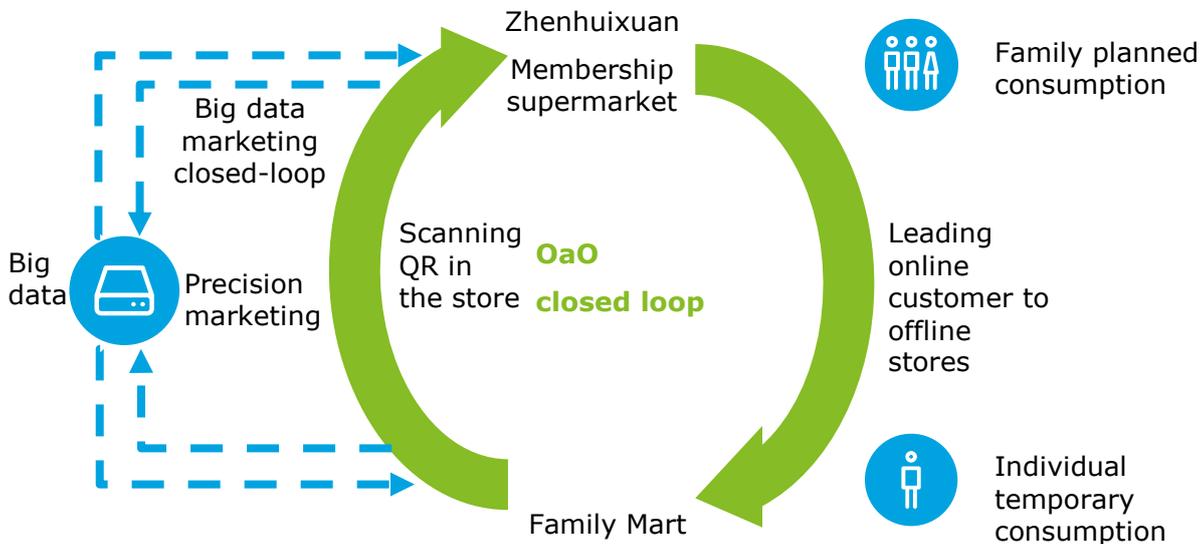
Figure 28 Omni-channel focuses



Source: Deloitte Digital (Digitalization's Impact on the Product/Supply Chain In-depth)

Centring on customers, Family Mart builds a unique OandO closed loop, namely online-to-offline closed loop and big data marketing closed loop. Online-to-offline closed loop, consisting of offline convenience stores and online membership supermarket (Zhenhuixuan), enables seamless connection with customers by means of omni-channel. In the loop, offline convenience stores would satisfy the temporary consumption of each individual, online membership supermarket would cover the planned consumption of whole family. In the process of obtaining and processing consumer data, Family Mart launches Customer Loyalty Management (CRM), Fans Club (Fans) and Customer Life Value (CLV), which would record and mark consumer behaviour to achieve integration and classification of related data. The interaction of consumption data in online and offline channels forms a loop of data streaming, which provides the basis for big data-based precision marketing and results in the formation of big data marketing closed loop. With such a closed loop system, Family Mart would focus on customer arrival frequency and per customer transaction, to optimize existing operation system and release new highlights, achieving maximization of customer value.

**Figure 29 OandO closed loop of Family Mart**



Source: Family Mart

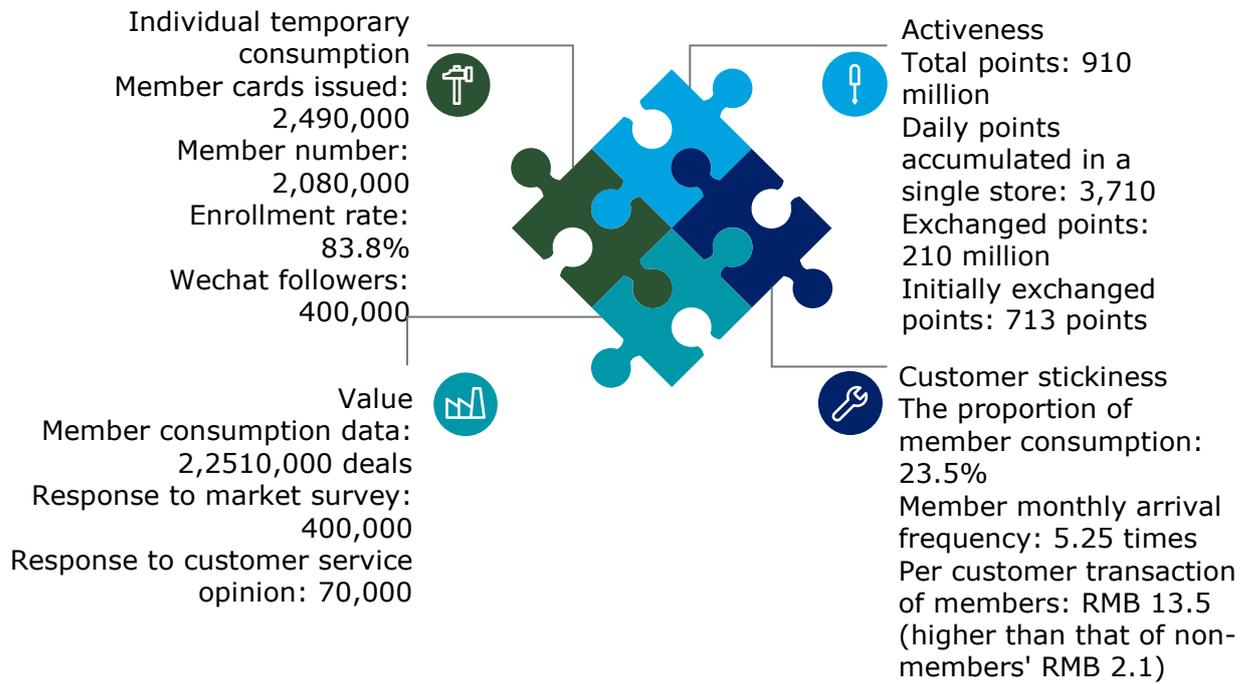
In the process of membership program, Family Mart take three major measures to increase customer arrival frequency and per customer transaction.

**Member Points Scheme.** By replacing discount with member points, Family Mart creates a new member points-based currency system where consumers gain points by purchase and use the points as money to exchange products. Member Points Scheme, another bond between Family Mart and customers, encourage them to continue making purchase in the store. Statistics indicates that Member Points Scheme has become an important driving force for the development of Family Mart. Half a year after the launching of Member Points Scheme, the total points and exchanged points have reached 910 million and 210 million respectively, and the average daily points accumulated in a single store is 3,710. Its member stickiness has remarkably improved in the first year of implementing such system. The proportion of member consumption has increased from 0% to 23.5%. Members' arrival frequency is 5.25 times and per customer transaction is RMB 13.5, higher than that of non-members' (RMB2.1).

**"Creating festivals".** Family Mart draws lessons on festival creation from online retailers, making attempts from the following two aspects. Firstly, release activities on several dates such as the date with periodic low sales and a specific date after the payday; secondly, release theme activities related to IP or movies to attract new generation of customer group with unique "funny products". "Crazy Family Mart Day" and "Crazy Wednesday" are the typical cases for festival creation.

**Online-offline exclusive membership scheme.** Family Mart combines paying members with E-shop focusing on low price and diversity. Annual fee somehow fills up the gross margin of low-priced products. Meanwhile, it also attempts to lead consumers to convenience stores via picking-up in a store so as to promote offline sales. It is shown that about 50% of customers makes additional purchase when they pick up their goods.

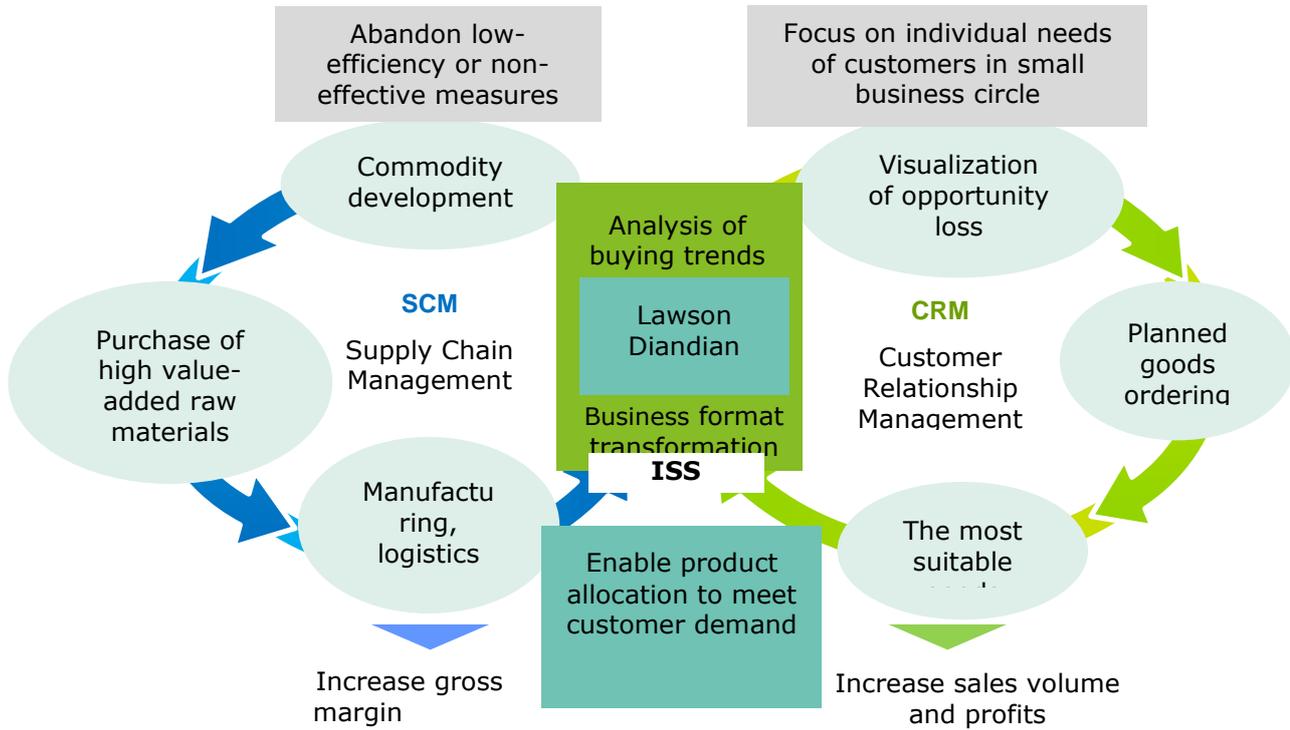
**Figure 30 Data in half a year after the launching of Membership Scheme in 2014**



Source: Family Mart

Lawson also makes use of its own membership system—Lawson Diandian—to connect Supply Chain Management (SCM) and Customer Relationship Management (CRM), based on which Lawson has established the model of " manufacturing retail in small business circle" to deploy products suitable for cities.

**Figure 31 Lawson's business model in China**



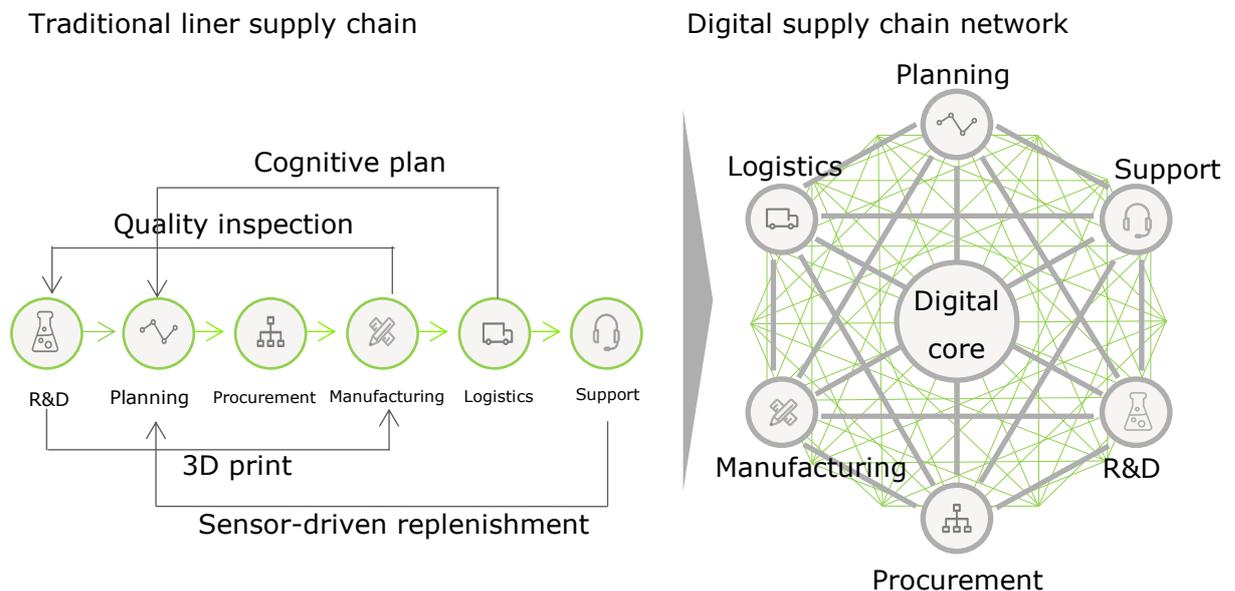
Source: Lawson

The cases of Family Mart and Lawson reflect the significance of omni-channel integration and the important impact on operation side and data side of such integration. Omni-channel provides not only a path to connect with customers online and offline but also possibilities for the formation of closed loop, further laying a foundation for the multi-dimensional application of data.

**Digital supply chain network**

In the new ecosystem, scientific development will drive the transformation of whole supply chain system from traditional liner supply chain to a dynamic net-like supply system. Digital core would enable interconnectivity within each node of supply chain; seamless data connection and flow allows each node to make timely adjustment and feedback. Therefore, the whole supply chain system will have more explicit and clearer understanding of customer demand, based on which each node would operate with higher efficiency, precision and individualization to better satisfy customer need while improving overall efficiency.

**Figure 32 The evolution of digital net-like supply chain**

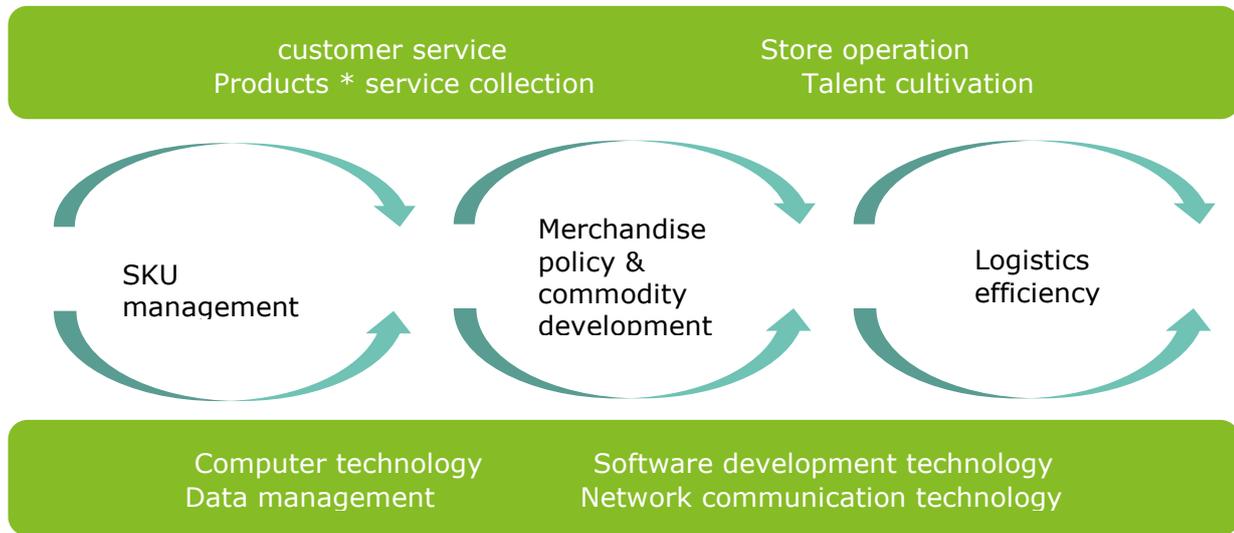


Source: Deloitte Digital

For convenience stores, one of the cores is supply chain management, which not only concerns what kind of products they can provide to meet customers' specific needs but also makes an impact on core processes of daily operation, such as the establishment of distribution network and store management. Therefore, the formation of net-like interconnection of supply chain with digital means has a far-reaching implications for their supply chain management.

For example, adhering to the goal of offering customers "desired quantity of desired products at required time", 7-Eleven makes continuous investment into digitalization and informatization so as to provide support in each link (order, merchandise policy and logistics, etc.).

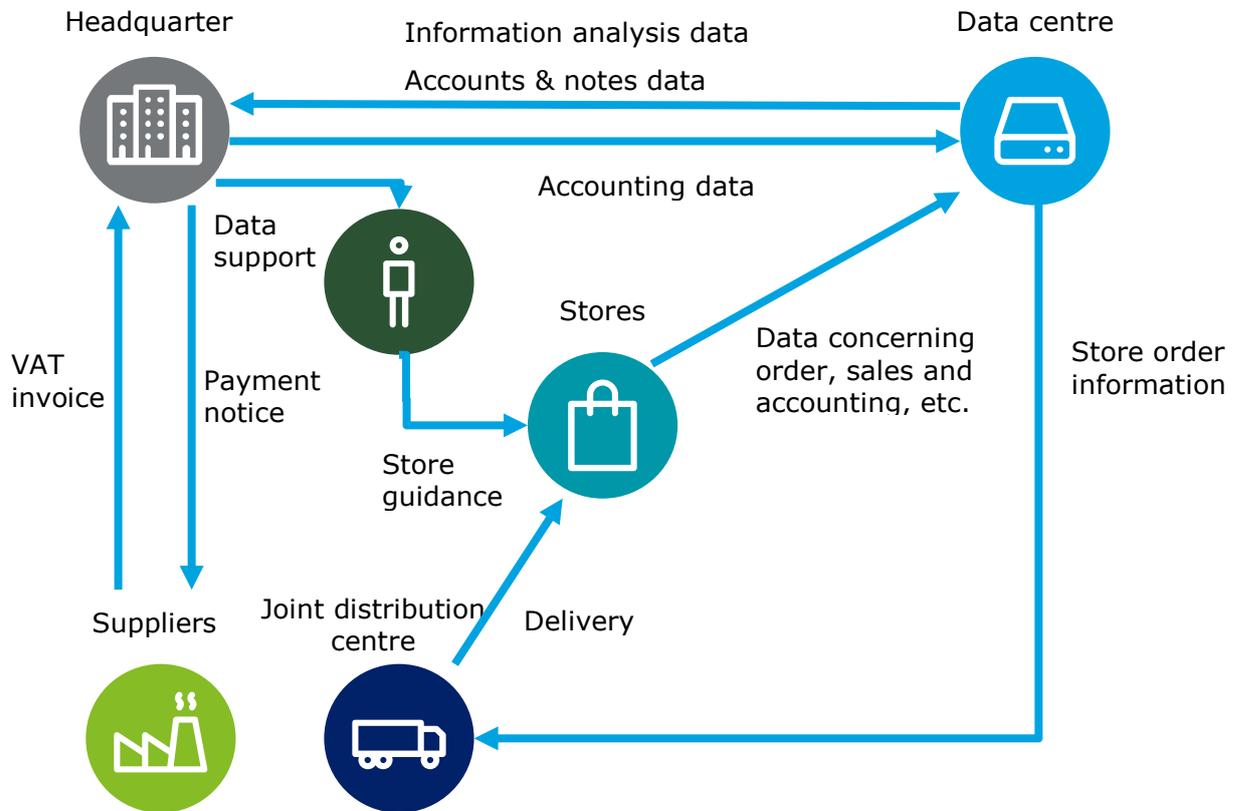
**Figure 33 7-Eleven information system positioning**



Source: 7-Eleven

7-Eleven establishes data-centred data interaction and integration information system with dedicated hardware and software. Similar to network supply chain model, the system would connect each link such as store, supplier, joint distribution centre and headquarter, etc. and enable interaction between each link via specific methods. With the support of digital system, 7-Eleven stores could make orders directly based on their own sales, effectively preventing overstocked inventory in stores and joint distribution centre. Meanwhile, 7-Eleven applies store order and sales data to its original commodity development process and logistics distribution process, which is supportive for enterprise development.

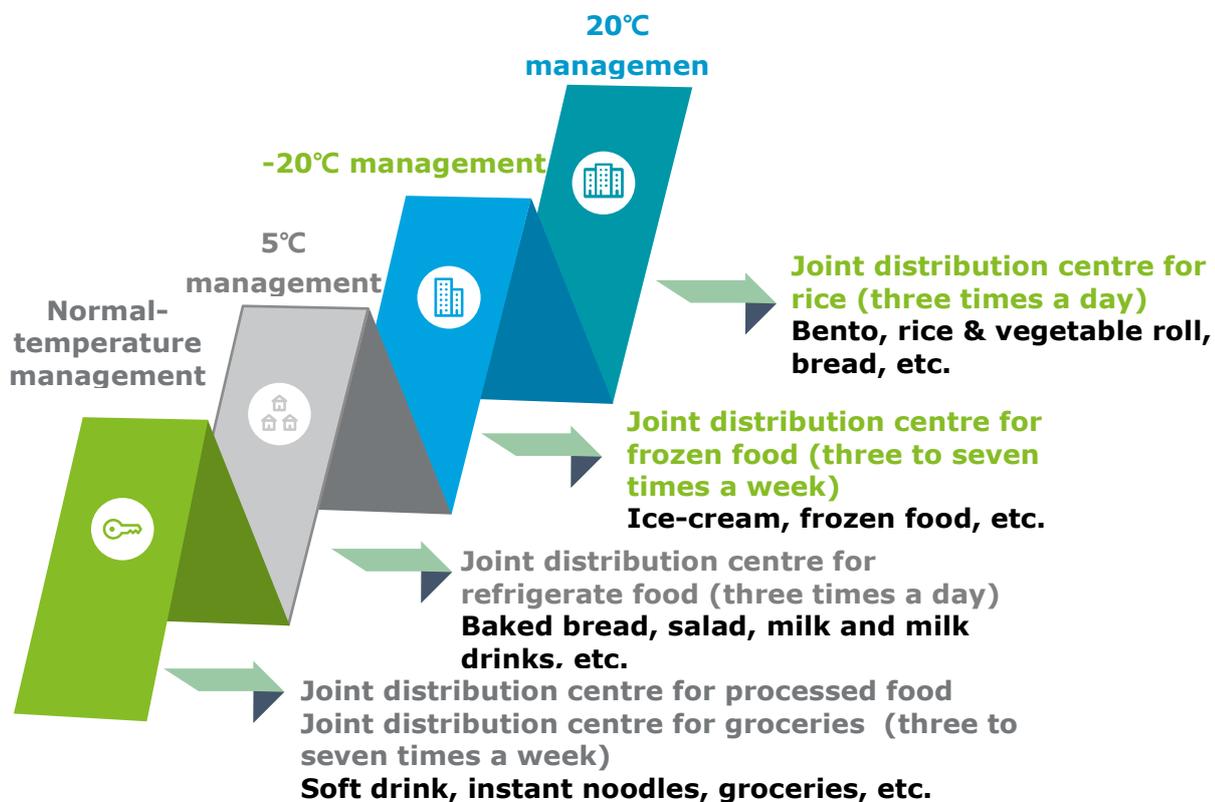
Figure 34 7-Eleven information system structure in China



Source: 7-Eleven

The logistics distribution model of 7-Eleven is established based on the support of digital network and information system. Instead of building its own logistics centre, 7-Eleven makes use of the cooperation with existing wholesalers to achieve multiple and small-scaled distributions for different types of products. With the joint distribution (using one vehicle to distribute products of several manufacturers), the distribution times via vehicles reduces from about 70 to 9.

**Figure 35 7-Eleven's logistics system classification and distribution frequency**



Source: 7-Eleven

7-Eleven shows the importance of connecting each link of supply chain via digital means and applying data scientifically to several aspects, like product R&D, logistics, store management, etc. To offer customers products and services precisely and continuously in the fiercely competitive market, convenience stores are required to attach great importance to digital transformation.

### Retail analysis

The digital transformation of the retail industry requires not only the integration of hardware but also the combination with mature theories and analysis methods for the optimization of various links of the retail industry, thus improving the overall operation performance of retailers and maximizing customer value. Deloitte has put forward a complete methodology based on customer service experience, covering three aspects of market insight, manufacturing, procurement & distribution, as well as sales & services. In accordance with the characteristics and requirements of different links, such aspects can be further subdivided into store optimization, personalization, customer insight, etc., in order to improve the performance of retailers through targeted problem solving and optimization. Retail analysis can be implemented in multiple dimensions by taking procurement, customer services, and efficiency improvement for example:

**Analysis-based procurement and sales:** establish more targeted rules related to commodity selection and pricing for higher profit margins through data analysis and customer insight; develop strategies for site selection as well as space and inventory allocation according to the situation of and prediction for customer demands in order to maximize the profits of stores; predict the effect of markdown promotion and formulate promotion schemes based on the data related to inventory and past sales, under the premise of not damaging profit margin and profitability. For example, enterprises often formulate promotion schemes based on their experience or by adopting qualitative approaches, during which there exist a limitation affecting profitability and sell-through rate – sales cannot be predicted scientifically and effectively. At present, Deloitte is assisting Tesco UK to

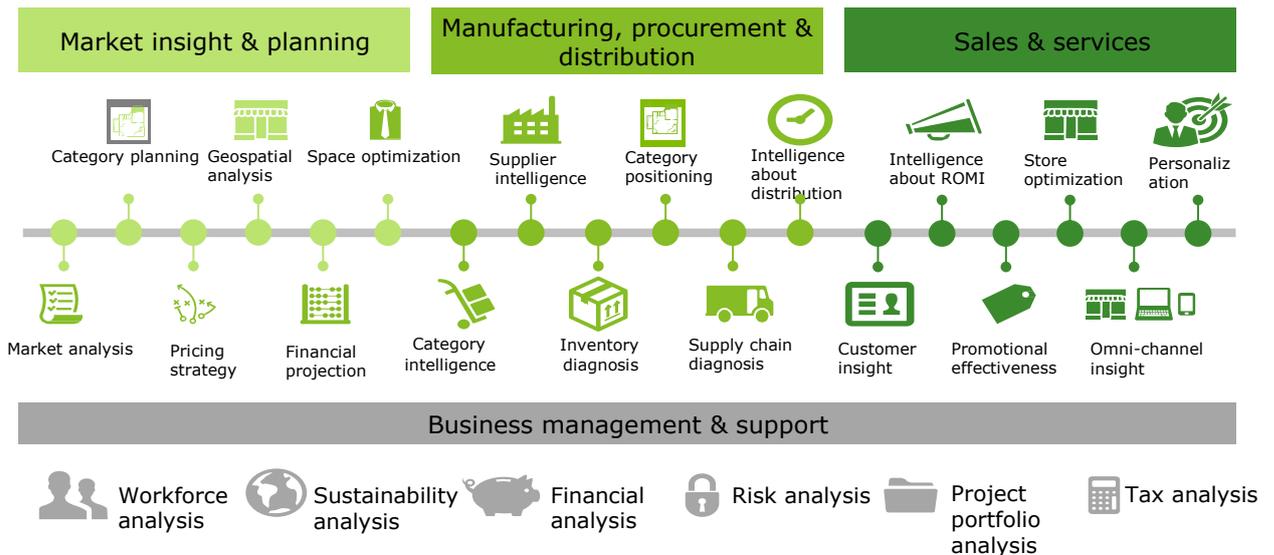
**Next stop for convenience stores**

formulate schemes for inventory clearance and markdown promotion on the basis of data analysis, which will effectively improve the clearance rate and increase the profit margin of about 5 percent. It is worth mentioning that Deloitte and Tesco have adopted an innovative, result-oriented, and value-based method instead of traditional ways to collect service fees – consulting firms charge fees based on the percentage of performance improvement of their customers. Deloitte team is vigorously promoting such a popular method in Japan and China in order to boost the operation improvement of retailers.

**Analysis-based customer insight and marketing:** build digital platforms to enhance data analysis capabilities and optimize marketing mixes through data modeling and testing/learning to maximize the return on marketing investment; increase the size and conversion rate of shopping baskets for sales improvement; conduct personalized cross-selling and up-selling activities based on customer portraits to maximize customer lifecycle value and wallet share; design specific loyalty programs according to enterprise strategies as well as customer segmentation and characteristics to discover the multiple demands of customers, to provide various products or services for satisfying customer demands, and to improve customer loyalty. The best practice of Tesco in customer loyalty management and precision marketing is to provide personalized coupons for different members with different shopping habits, which will not only enhance the stickiness of members by making them pleasantly surprised but also avoid the blindness and profit loss caused by sales promotion facing all customers in traditional offline retail stores.

**Analysis-based improvement of operation efficiency and effectiveness:** conduct analysis to assist retailers in coping with various human resources issues (including issues regarding staff recruitment and talent retention), to improve customer conversion rate and sales performance of stores, and to optimize the transfer of store personnel based on customer flow. One of Deloitte’s customers in the UK, a retailer in media and telecom industry, faced great difference in customer conversion rate of various stores, which will affect the achievement of sales targets. Accordingly, Deloitte conducted data-based analysis on various personnel and all operating areas, quantified their impact on store performance, and assisted to formulate concrete schemes, thus enabling store sales of that year to substantially exceed intended targets.

**Figure 17 Retail analysis facilitating value chain collaboration**

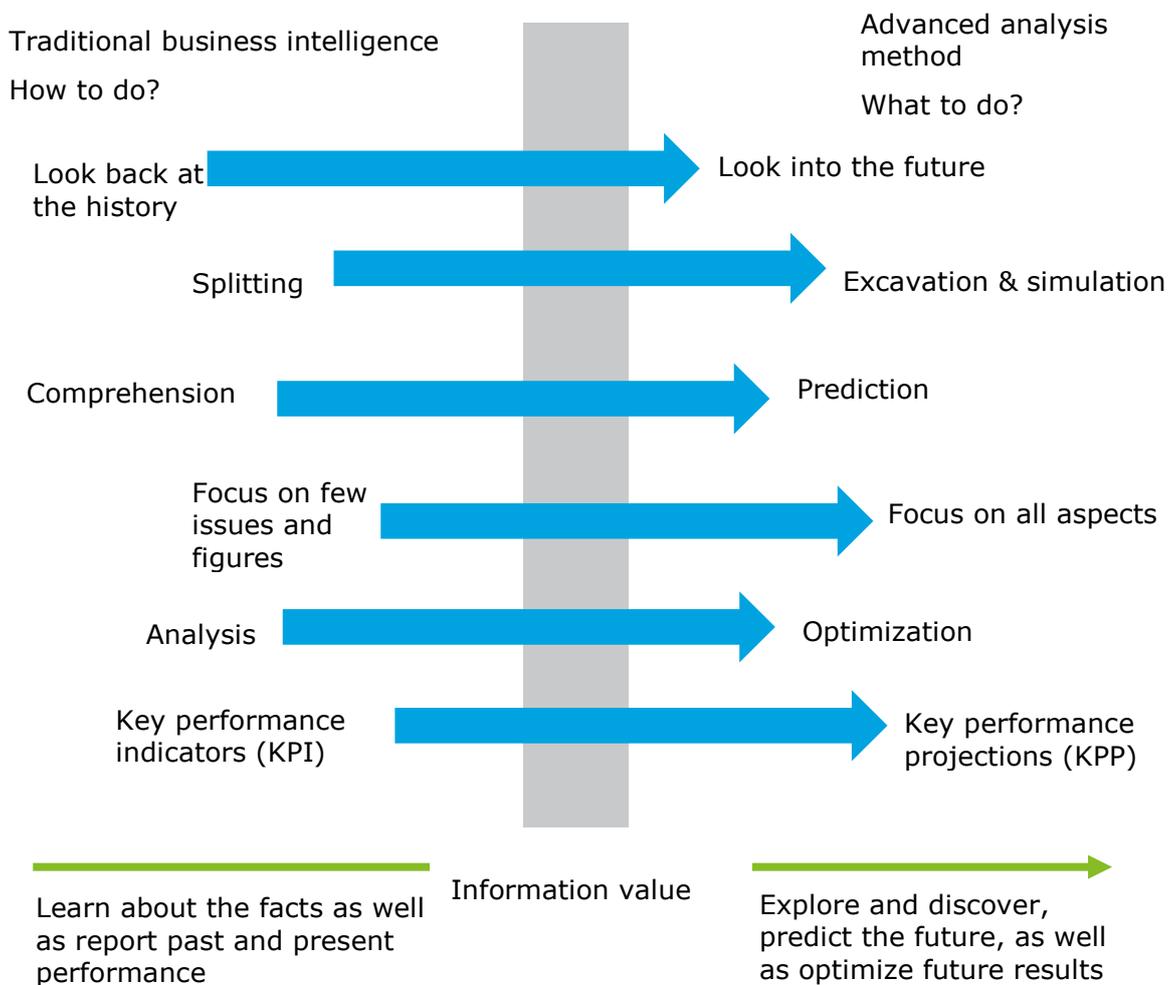


Source: Deloitte Digital

Retail analysis could enable enterprises to obtain more forward-looking insights and targeted action recommendations, designed to transform the analysis pattern for traditional retail business from the analysis of historical and present situation to the exploration, prediction, and simulation of the future

in order to conduct optimization for circumstances likely to occur in the future. As for convenience stores, a similar analysis method could help such enterprises to be more forward-looking and systematic during the digital transformation, which can not only improve efficiency but also more accurately satisfy customer demands and significantly enhance enterprise competitiveness.

**Figure 18 Purpose of Deloitte analysis**



Source: Deloitte analysis

### III. What will reshape the convenience store industry?

Continuous and stable development, policy support, and capital investment are attracting more and more "outsiders" to swarm into the convenience store industry, including not only e-commerce enterprises like Alibaba and JD.com that expect to carry forward omni-channel layout by setting foot in the industry, but also well-known brands like Wahaha and LaiYiFen that hope to expand retail channels of direct sales through some models such as unattended convenience stores. The convenience store industry, driven by science and technology, is experiencing increasingly diversified development, so new participants are likely to be the key force reshaping the industry.

### 1. E-commerce enterprises turning to offline channels

Owing to the fact that e-retail sales growth has slowed down year by year, e-commerce enterprises like Alibaba and JD.com begin to accelerate the integration with offline resources in order to gain more space for growth and imagination. As the new retail era approaches, the trend of online and offline integration is becoming an important factor that will affect the development of convenience stores. For the purpose of better gathering offline resources of convenience stores, Alibaba and JD.com launched LST and smart convenience store management system respectively, aiming to help improve the operation performance of convenience stores through resource integration and by digital means.

For example, Alibaba's LST is designed to establish an intelligent distribution network along with brand owners and dealers for sharing the distribution system with low-cost and high-efficiency warehousing, distribution, and personnel within the entire FMCG industry, which will not only enable brand owners to cover the distribution network more efficiently and accurately, but also help millions of unchained grocers to obtain omni-channel service and data support.

**Figure 19 LST empowering the intelligent distribution network**



Source: Alibaba

The development of LST relies on six strategies:

**Strategy 1: provide small-scale stores with abundant and competitive high-quality goods.**

1. Selection. Take advantage of big data to improve customer portraits and to make personalized selections. 2. Supply. Acquire fast moving consumer goods primarily from Tier-1 authorized distributors; collaborate with brand owners to design and provide goods satisfying market demands, mainly involving commodity packages and specifications (brand owners include pure online brands, online brands at Tmall Global, and suppliers of agricultural products (Rural Taobao)); increase commodity richness and provide competitive prices by directly integrating or establishing distribution systems.

**Strategy 2: establish a compatible and efficient three-level warehousing and distribution system.**

LST aims to establish a three-level warehousing and distribution system in order to integrate brand owners with different distribution coverage, including regional warehouse, urban warehouse, and lead warehouse. Regional warehouse, usually covering three to four provinces, is used for the storage of differentiated goods purchased at a low frequency. Urban warehouse, covering two to three prefecture-level cities, is used for the storage of fast moving consumer goods of the brands with medium distribution coverage. Lead warehouse, targeted at one district or county, is used for the storage of dairy beverages purchased at a high frequency, for which the partners are dealers of the brands with high distribution coverage.

**Strategy 3: build a professional social retail team.** The social retail team consists of urban partners, which include individual partners among self-employed businesses for first-tier to third-tier cities as well as enterprise partners among dealers for third-tier to sixth-tier cities. Urban partners shall be responsible for: 1. looking for new small-scale stores; 2. assisting small-scale stores to use LST platform; 3. promoting the sales of LST-selected goods to fulfil the mission of brand promotion; 4. providing small-scale stores with customer services, value-added services, and after-sales services; and 5. offering professional recommendations to small-scale stores with excellent performance.

**Strategy 4: achieve comprehensive expansion of regions, channels, and industries.** For the next year, LST will expand the coverage area from more than 800 districts and counties at present to 1,500 districts and counties. In the second half of 2017, LST will take advantage of differentiated goods to include monomer stores and chain stores.

**Strategy 5: fully upgrade services facing monomer stores.** So far, LST has been the only B2B platform that offers credit sale services to the owners of small-scale stores. In addition, LST provides recharge services for customers arriving at such stores, for which store owners will receive competitive commissions. LST is committed to render best-quality basic services for small-scale stores and spread touch points to the areas covered by urban warehouses in order to provide after-sales services within 48 hours.

**Strategy 6: join hands with high-quality small-scale stores to embrace the new retail era.** LST will provide brand licensing services for small-scale stores with good locations, numerous customers, guaranteed quality, and high-level services. Different from channel licensing services for convenience stores, LST will offer personalized services to the stores having obtained brand licensing (including personalized transformation, distribution of more abundant goods, intelligent store management system, etc.), thus assisting small-scale stores to establish omni-channel operation capability for rapid improvement of operation efficiency.

E-commerce enterprises will further achieve resource integration and optimization by empowering offline convenience stores:

**More comprehensive and in-depth coverage for customers.** E-commerce enterprises could achieve more comprehensive coverage for offline customers because of massive resources obtained by providing services for convenience stores and rapidly realize channel sinking with the help of the stores located in villages and towns.

**Acquisition of high-frequency transaction data and further integration of online and offline data.** Convenience stores, characterized by low prices and high frequency of transactions, will produce a large amount of transaction data, which could be obtained by e-commerce enterprises through the coverage for convenience stores to facilitate the integration of online and offline data.

**Improvement of logistics network.** As the offline logistics node of e-commerce enterprises, convenience stores are of vital importance for improving logistics network and enhancing last-mile experience.

E-commerce enterprises are faced with many practical issues in pushing forward the above plans. E-commerce enterprises need help convenience stores (mainly in the form of mom-and-pop stores in many regions) to improve performance to enhance their stickiness and establish an effective management mechanism to restrain and standardize the behaviors of store owners, both of which are the challenges to integrate such stores.

E-commerce enterprises render assistance in the transformation of traditional convenience stores through the output of existing resources and technologies as well as provide convenience stores with low-priced and high-quality goods, which could address issues in the development of convenience stores to a certain extent and achieve more powerful resource integration. It is likely that a number of comparatively uniform and more competitive convenience stores will rapidly emerge in China's convenience store market through the empowerment to traditional convenience stores (especially

numerous mom-and-pop stores), which may produce an impact on relatively weak chain convenience stores.

## 2. Accelerated emergence of new-type retailers

With the continuous advancement of retail transformation, new-type retailers represented by Hema Fresh emerged rapidly in 2016 to be strong contenders in the market because of Internet-based operation philosophy, omni-channel layout, integration of retail and catering services, supply chain integration, and strong resource support. In 2017, the retail industry enter into a frenetic period during which new-type retailers accelerate multiplying. According to incomplete statistics, new-type retailers that have been born this year alone include sp@ce of Rainbow, Haiwuhui of New Huadu, Fresh Ideas of Better Life, RISO of Bailian, Zhangyushengxian (掌鱼生鲜) of Meituan.com, Jingxuan (鲸选) of Century Mart, etc. Although new-type retailers like Hema Fresh differ from convenience stores in scale and number, the emergence of such new-type retailers represents increasingly ambiguous boundaries of retail formats and more diversified service items. Evolving operation models and commodity categories of new-type retailers are likely to overlap with those of convenience stores to a certain extent. As the store layout proceeds gradually along with the continuous deepening of format innovation and category optimization, new-type retailers may be another competitor of convenience stores.

For example, Hema Fresh of Alibaba has established the operation model with the integration of retail and catering services as well as online and offline channels after more than one year of development in order to meet diversified customer demands through more accurate product services and more powerful customer experience. Hema Fresh is characterized as follows:

**Customers within the radius of three kilometres.** Hema Fresh has established the omni-channel system to satisfy the demands of customers living within the radius of three kilometers by means of high-efficiency delivery services in half an hour at the soonest and retail + catering services at offline stores.

**Support of digital backend systems.** Hema Fresh has been more intelligence and automatic in multiple aspects due to digital infrastructure architecture and system architecture as well as established the closed loop of consumption data and online channels for customers with the help of Alibaba's resources like Alipay.

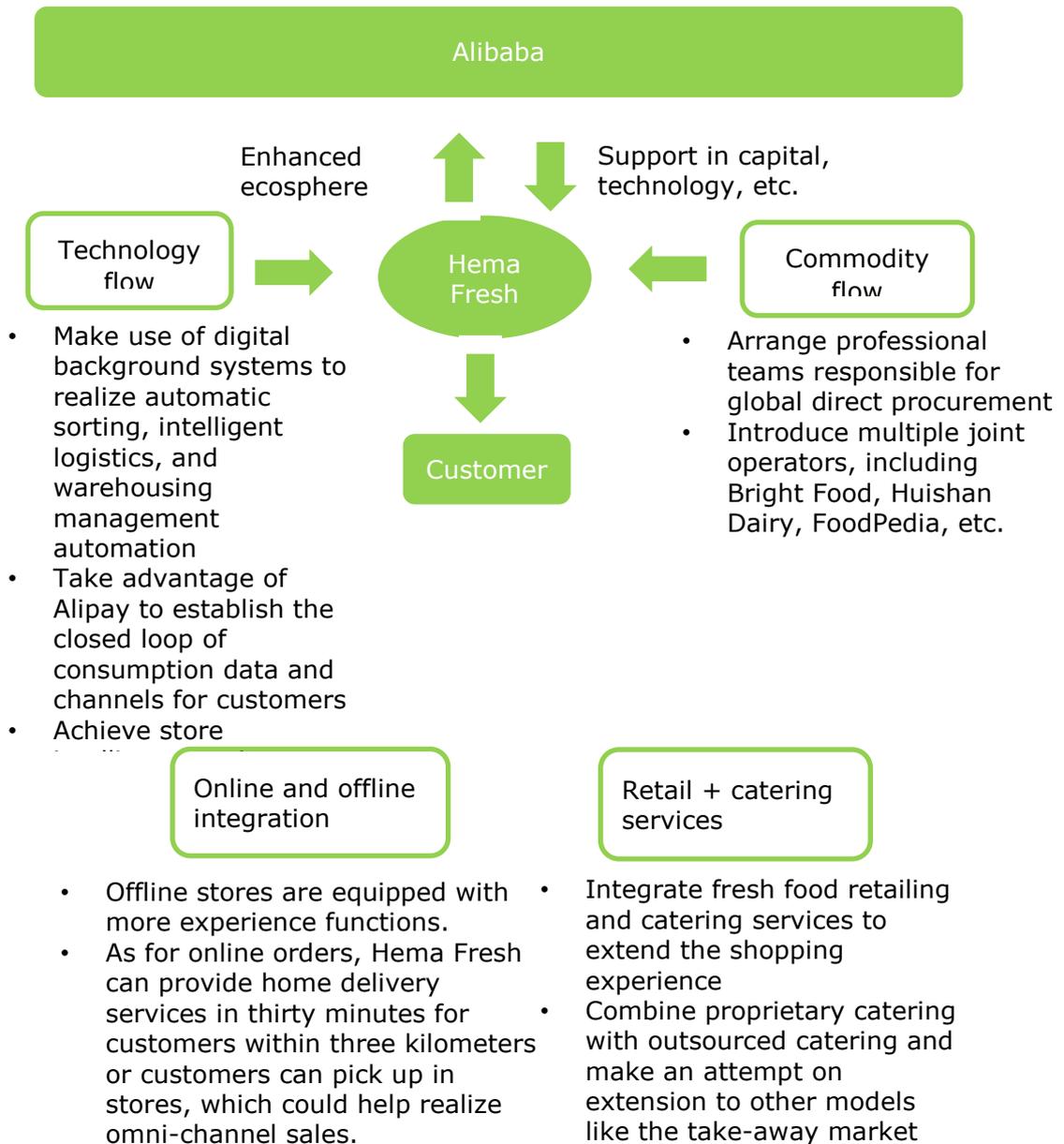
**Supply chain system.** Hema Fresh has introduced multiple product suppliers through the way of joint operation and arranged professional teams responsible for global direct procurement.

**Omni-channel model.** Hema Fresh has established the systems for customer operation, commodity management, and warehousing and distribution with the integration of online and offline channels, in which online and offline stores could realize inventory sharing, achieve digital management for procurement, sales, and inventory, as well as improve operation efficiency under the model of stores in the front and warehouses in the rear.

**Innovative experience with the integration of retail and catering services.** Hema Fresh has introduced food specialties into stores to provide customers with on-site catering services in the form of proprietary trading and outsourcing for the purpose of increasing the sojourn time of customers. And meanwhile, Hema Fresh has marched into the take-away market to expand business models.

**Resource support from the super platform.** Hema Fresh has enjoyed rapid development, which is closely related to Alibaba's support in multiple aspects like capital, technology, etc. For Alibaba, the innovative model of Hema Fresh is an exploration to omni-channel development.

Figure 20 System of Hema Fresh



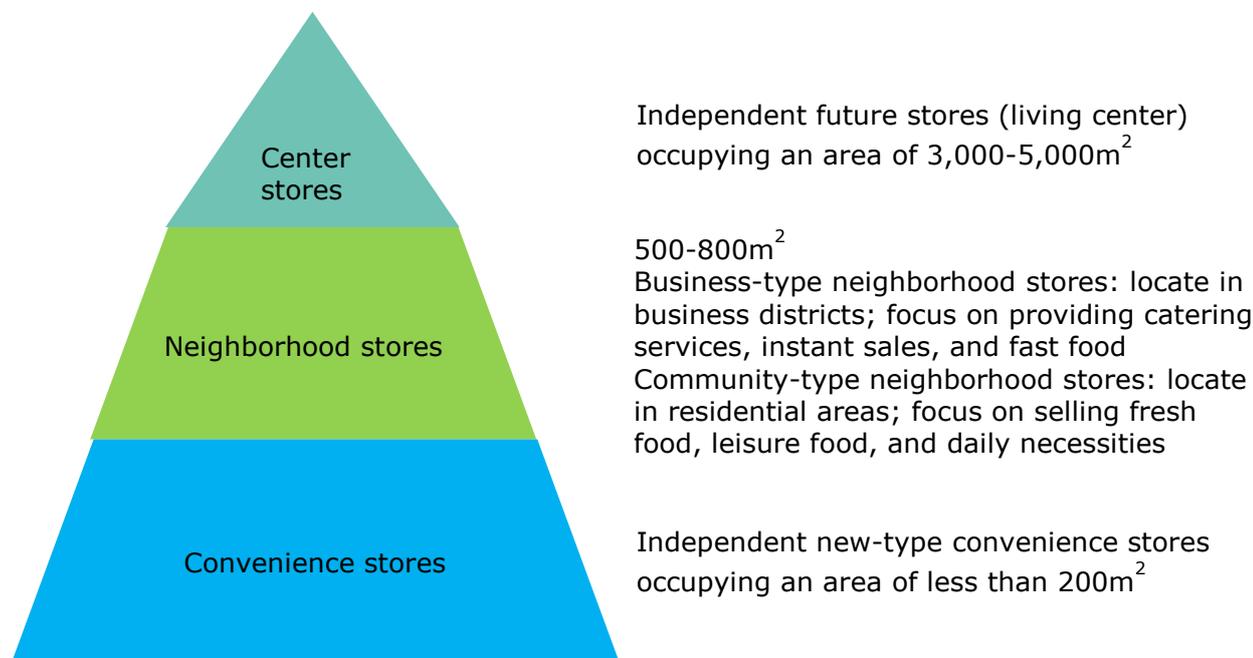
Source: Deloitte research

Compared to Hema Fresh with a large scale, Super Species (hundreds of square meters) and YH Life (less than 200 square meters), both of which are subordinate to Yonghui Superstores, occupy a smaller area. Adhering to the philosophy of future supermarket + catering, Super Species aims to satisfy the diversified demands of customers by virtue of omni-channel strategy and strong experience. As the store with a new type of retail model, YH Life is closer to life and community, mainly selling fresh food in order to improve last-mile experience through YH Life APP and community partners. As a result of occupying a smaller area, Super Species and YH Life need lower initial investment and therefore will be more aggressive in store expansion. Super Species plans to open 25 to 50 stores in 2017, while YH Life has opened 57 stores in July 2017.

In June 2017, Bailian Group launched RISO and announced the interaction strategy involving multiple business formats in the new retail era. Targeting post-80s/90s generation, the new business model could provide customers with better experience and more convenient services by presenting multi-

dimension shopping scenarios, combining retail and catering services, and integrating new services such as online APP, one-hour delivery, processing services, etc.

**Figure 21 Bailian Group - interaction of multiple business formats**



Source: Deloitte research

**Table 2 Comparison between convenience stores and major new-type retailers**

	<b>Convenience stores</b>	<b>Hema Fresh</b>	<b>Super Species</b>	<b>YH Life</b>
<b>Commodity category and business model</b>	Fast food, daily necessities, processed food, groceries, etc.	Retail + catering + online business + delivery, featured by the sales of fresh food and with more SKUs than convenience stores	Retail + catering + online business, featured by the sales of fresh food and with more SKUs than convenience stores	Online business + offline business, featured by the sales of fresh food and similar to convenience stores
<b>Occupied area</b>	Dozens of square meters – more than 100 square meters	More than 4,000m <sup>2</sup> (Hema Market covers an area of nearly 10,000m <sup>2</sup> )	About 500m <sup>2</sup>	About 200m <sup>2</sup>
<b>Proportion of online business</b>	Different	Over 50%	About 10%	-
<b>Operation model</b>	Franchised store/proprietary trading	Proprietary trading + joint operation	Partnership model	Partnership model

**Next stop for convenience stores**

<b>Delivery service</b>	Delivery through third parties, with relatively great uncertainty	Delivery in half an hour at the soonest for customers within three kilometers	Under optimization	Under optimization
<b>Payment method</b>	Multiple payment methods	Alipay centered and cash supplemented	Multiple payment methods	Multiple payment methods
<b>The number of stores and the plan to open stores</b>	Differ in the number of stores, ranging from several hundred to several thousand	Plan to open over 50 stores in the future	Plan to open 25 to 50 stores in 2017	Have opened 50 stores

Source: TF Securities, public information collation, Deloitte research

It can be found from the above comparison results that new-type retailers, mainly characterized by retail + catering services and online + offline business, adhere to more digital and youthful operation philosophies in order to be closer to the new generation of customers in terms of management and category selection. With the continuous evolution of the overall arrangement involving new-type retailers and multiple business formats as well as the increase of store density, new-type retailers and convenience stores, despite differences in business formats and major categories, will overlap with each other in respect of some major categories and services (such as catering and fast food) and enter into competition with each other, which may enable new-type retailers to be another factor affecting the development of the convenience store industry.

**3. Rise of diversified service providers**

Science and technology development and industry transformation lead to the emergence of various service providers, who attempt to reshape existing industry structure by changing consumption scenarios and rebuilding supply systems in order to be the centers for resource integration or the providers of core technology for the improvement of industry efficiency and the achievement of resource aggregation. The above process involves unattended convenience stores attracting extensive attention and service providers serving convenience stores.

**Unattended convenience stores**

Another keyword associated with Alibaba in 2017 is unattended convenience store, which is regarded as a model of technology and hardware output in the future. Alibaba official launched "Tao Cafe" at the 2<sup>nd</sup> Taobao Maker Festival in July 2017, thus igniting the concept of unattended convenience store. Before that, there are many domestic enterprises who have set foot in this area, such as the unattended convenience stores of Bingo Box and DeepBlue Technology having been put into commercial use. Moreover, some large enterprises have announced development plans for unattended convenience stores.

**Table 3 Comparison of existing unattended convenience stores**

<b>Amazon Go</b> Occupied area: More than 200m <sup>2</sup> Upper limit of customer flow volume: Less than 20 people Highlight: A typical example in object identification of visual genres Disadvantage: High technical cost, and difficulty in identification under a large customer flow	<b>Tao Cafe</b> Occupied area: More than 200m <sup>2</sup> Upper limit of customer flow volume: 50 people Highlight: "Payment Door", face identification, etc. Disadvantage: Incapability of making payment by several people at the same time, and increased cost due to identification technology
<b>Bingo Box</b> Occupied area: 15m <sup>2</sup> Upper limit of customer flow volume: Relatively low capacity available Highlight: High commercial value and cost performance Disadvantage: Average user experience, absence of data backflow and precipitation, and increased cost due to RFID	<b>QuiXmart &amp; TakeGo</b> Occupied area: 3-10m <sup>2</sup> Upper limit of customer flow volume: Relatively low capacity available Highlight: The first unattended convenience store with pure visual technology in China Disadvantage: High identification error rate, long warehouse entry time, and high cost

Source: Deloitte research

Potential advantages of unattended convenience stores are the main reason to attract enterprise investment, mainly including:

**Higher efficiency.** Unattended convenience stores with mature technology can reduce checkout time and improve shopping efficiency.

**Lower cost.** Traditional convenience stores need shop assistants to maintain routine operation, while unattended convenience stores just need specific personnel responsible for supply and maintenance in working areas, so unattended convenience stores under mature operation can save labor cost. In addition, the quantity of goods sold by a 15-square-meter unattended convenience store is equivalent to that of a 40-square-meter traditional convenience store, which will save rental cost to a certain extent.

**Quick replication.** Despite high R&D cost, unattended convenience stores with mature technology will be easier to replicate than ordinary convenience stores. There is no need to train cashiers for unattended convenience stores, such as just setting up another Bingo Box to start the operation. What's more, the replication cost is relatively low – traditional convenience stores need to input about RMB400,000, while unattended convenience stores just need about RMB100,000.

Apart from potential advantages, there exist many issues and disadvantages in unattended convenience stores:

**Profitability.** Like ordinary convenience stores, unattended convenience stores mainly sell snacks and beverages at present for such goods are easy to preserve and able to satisfy most of customer demands as well as it is difficult to sell fresh food with high gross margin in the convenience store

## Next stop for convenience stores

industry due to technical reasons. On account of the differences in commodity categories and services, consumption amount per customer transaction of unattended convenience stores is relatively low. Therefore, enterprises need to address the issue of how to improve the profitability of unattended convenience stores from various aspects.

**Technology.** Domestic unattended convenience stores, equipped with immature technology, cannot provide "buy-go" experience and will be affected by some human or non-human factors in terms of commodity scanning and identification. What's more, the upper limit of customer capacity of unattended convenience stores is relatively low (1-5 people in general), so the case in which several people purchase at the same time may lead to system breakdown. Generally speaking, with technology in a development state, there is still a gap in widespread popularization and operation of unattended convenience stores, which therefore need to establish an accurate and efficient supply chain system.

**Regulation and security.** There is no shop assistant responsible for on-site supervision, so the credit problem has been a challenge for unattended convenience stores. The issues in this aspect (such as artificial interference in commodity identification, destruction to goods at stores, and security issues caused by stealthy substitute), which are complicated and difficult to address, deserve attention.

Cooperation between brand retailers and unattended convenience stores

Unattended convenience stores have attracted the attention of not only retailers and capital market, but also brand owners. Some foregoers like Wahaha, LaiYiFen, and Yili have signed cooperation agreements with DeepBlue Technology on market expansion in the future.

**Table 4 Investment of brand owners in unattended convenience stores**

Brand owner	Investment plan
Wahaha	Open 100,000 unattended convenience stores in 3 years and 1,000,000 in 10 years
LaiYiFen	Establish 1,000 unattended intelligent stores in Shanghai
Yili	Promote unattended convenience micro-stores in more than 2,000 communities

Source: Deloitte research

There are several factors driving representative enterprises in beverages and snacks to reach customers by means of unattended convenience stores:

**Unattended convenience stores are more suitable to sell food and beverage products.**

Unattended convenience stores could serve as the sales terminal to directly reach customers like a large vending machine.

**Representative enterprises establish terminal channels by means of unattended convenience stores.** There always exist a problem of high cost due to impeded passage, belated data backflow, and overlong supply chain between retailers and brand owners, so brand owners with a strong desire for disintermediation may choose to establish terminal channels to directly reach customers. Unattended convenience stores could assist brand owners to promote the sales of proprietary brands, establish the channel for direct interaction with customers, as well as achieve the exchange and backflow of data and information.

Unattended convenience stores having been under operation are not fully mature in terms of technology and faced with great limitations in occupied area and commodity category. The operation of unattended convenience stores is based on the output of capabilities, so the stores with outstanding capabilities in commodity supply, software and hardware technology, overall arrangement, and operation could survive in the fiercely competitive retail market. Unattended convenience stores with improved technology, which are expected to be one type of retail formats in the future, will be established in specific regions for the sales of some categories. Unattended convenience stores, featured by high efficiency and low cost, may gain some advantages in the competition with existing mom-and-pop stores, thus obviously affecting the retail market.

### **Integration and output of operation and management resources**

Demands for the transformation and upgrading of the retail industry have promoted the emergence of numerous new-type retail service providers focusing on technology services and resource integration, who hope to help improve the operation performance of convenience stores through the integration and optimization of supply chain resources as well as operation and management optimization for convenience stores. Such service providers are similar to e-commerce enterprises like Alibaba and JD.com in terms of business models.

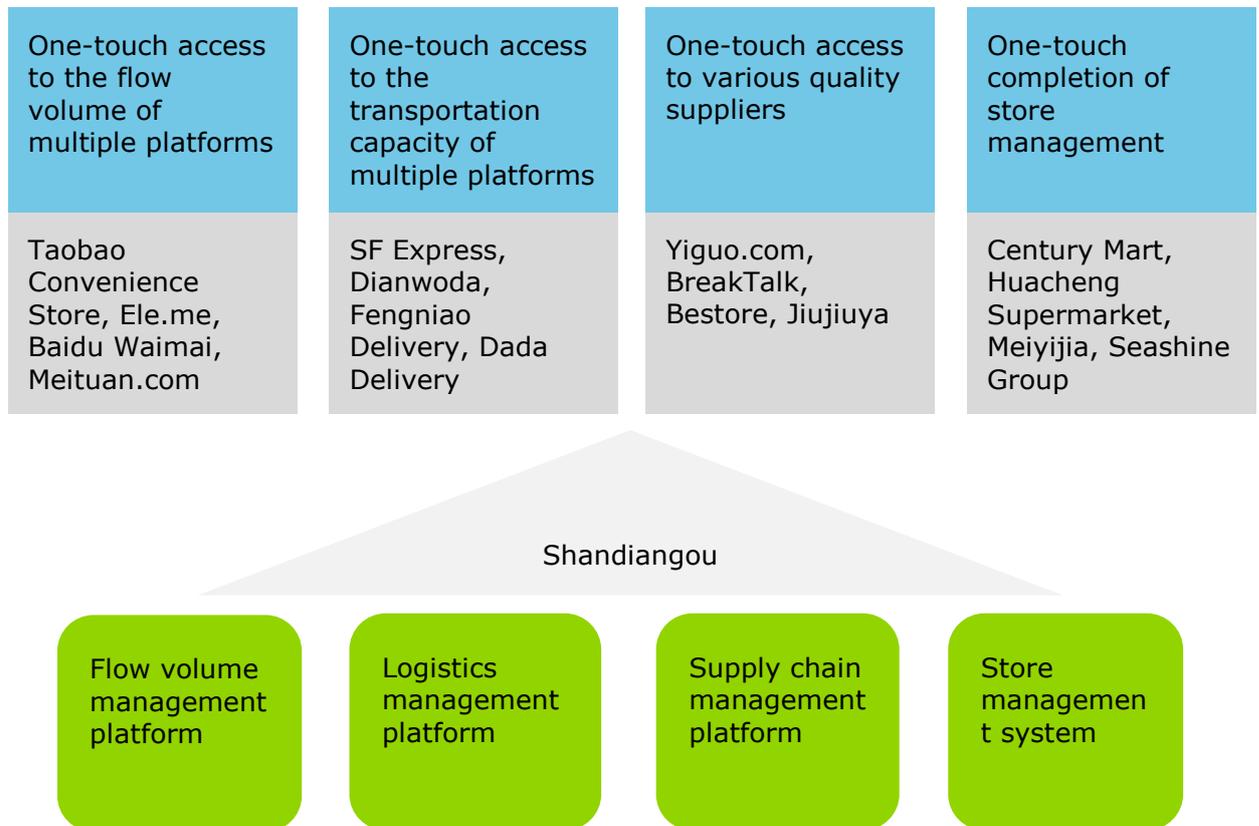
**Table 5 Comparison of retail service platforms**

<p><b>Shandianguo</b></p> <p>Aim to establish the one-hour urban terminal network covering the whole city, with the integration of warehousing and distribution capability, goods structure, and online and offline operation capability (an intermediate platform to provide basic services in the new retail era)</p>	<p><b>Pinpianyi</b></p> <p>An intelligence procurement platform for middle- and small-scale convenience stores and established by using an algorithm, designed to address the issues facing convenience stores, such as inventory backlog, high procurement cost, loss caused by expired goods, etc.</p>
<p><b>Zhongshang Huimin</b></p> <p>The intelligent terminal "Huifutong" (惠付通) with the integration of ordering system for merchants, general settlement system, online supermarket, and convenient services, which could check inventory based on background data to improve the inventory turnover rate</p>	<p><b>I Believe</b></p> <p>A community-centered business system in the retail ecosystem based on B2B (flat supply chains) + CVS (chain convenience stores) + O2O (in-depth services for communities), with the integration of online and offline resources to achieve the interconnection of online and offline channels and provide more prompt delivery services for communities</p>

Source: Public information collation, Deloitte research

Despite differences in priorities, such enterprises are the platform and bond to connect the whole chain in essence. For example, Shandianguo empowered convenience stores through the way of one-touch access by integrating resources and technologies in flow volume, transportation capacity, suppliers, and store management, thus realizing the interconnection of goods, supply chains, convenience stores, logistics, and customers.

**Figure 22 Shandianguo platform**



Source: Shandianguo

In spite of some overlap in service model, new-type retail service providers and e-commerce enterprises are expected to jointly promote the transformation and upgrading of China's convenience store industry from multiple dimensions and in multiple regions due to China's unconcentrated and growing market, which will help a large number of traditional small-scale retail formats (like mom-and-pop stores) to go one step further in the aspects like supplier management, customer management, and store management as well as transform to be modern new-type convenience stores providing more accurate and efficient services for customers.

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