Small format shops, especially convenience stores (CVS) and community stores, have gained popularity over the years as consumers are getting more mature and demanding more convenient shopping experience. As small-scale retailer, CVS has the advantage of being more accessible to customers, while offering quicker services and better experience. As with other retail formats, the CVS sector has undergone rapid transformation and reinvention in the rapidly evolving retail environment. CVS is the pioneer of retail transformation and reinvention, as well as an active participant in online-to-offline (O2O) integration.

I. Market overview

1. China’s CVS sector sees rapid sales growth

CVS has been the fastest-growing retail format in China in recent years. According to a report by the China Chain Store and Franchise Association (CCFA) and the Boston Consulting Group (BCG), total sales revenue for the CVS sector (including forecourt stores) reached 190.5 trillion yuan in 2017, up 23% year-on-year (yoy) (Exhibit 1). The growth momentum of CVS is expected to continue, as small retail format continues to gain in popularity in China’s retail market. Data from the Ministry of Commerce (MOFCOM) show that the yoy growth of 5,000 key retailers reached 4.6% yoy in 1H18, with CVS recording the fastest growth among all retail formats: 7.6% yoy, compared to 4.5% yoy for supermarkets and 1.6% yoy for department stores.
In 2017, the total number of CVS in China increased by 13% yoy to reach over 100,000, up from 94,000 in 2017, indicating that the store opening speed is very fast in the sector (Exhibit 2).

Source: China Chain Store and Franchise Association, BCG; compiled by Fung Business Intelligence
2. Overall prosperity index remains stable in 2Q18

According to the “Report on the Prosperity Index of China’s Convenience Stores” released by the MOFCOM, the development of the CVS sector has remained stable and healthy throughout 2017 and 2018. The overall prosperity index of China’s convenience stores was around 70.00 in the previous quarters, much higher than the 50-point threshold (Exhibit 3).

3. Domestic CVS players take the lead

Currently, most leading CVS players in China are regionally based. As shown in Exhibit 4, Easy Joy and uSmile\(^1\) have the most number of stores in China, followed by regional players Meiyijia, Tianfu and Hongqi. It is noteworthy that Easy Joy and uSmile operate mainly forecourt stores, thus they have more stores than others. Meiyijia, with 11,659 stores in China in 2017, greatly outnumbered that of local peers Tianfu and Hongqi. Foreign player FamilyMart only came sixth on the list in terms of store numbers.

Recently, it is notable that both foreign and domestics CVS operators are expanding fast around the country. This is different from the past where foreign CVS operators sought to expand nationally, while domestic players focused mostly on regional expansion. As of July 2018, 7-Eleven has 2,244 branches across China, of which over half of them were opened in the past three years. Lawson has 1,642 branches in China as of June 2018, of which 990 of them were

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\(^1\) Easy Joy and uSmile operate mainly forecourt stores in China.
opened in the past three years. Meanwhile, domestic player Meiyijia has been actively expanding outside of Southern China into other provinces such as Shanghai, Zhejiang, Guizhou and Hunan.

<table>
<thead>
<tr>
<th>Rank</th>
<th>CVS brand</th>
<th>Parent company</th>
<th>No. of stores</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Easy Joy</td>
<td>Sinopec Group</td>
<td>25,775</td>
</tr>
<tr>
<td>2</td>
<td>uSmile</td>
<td>PetroChina Co., Ltd.</td>
<td>19,000</td>
</tr>
<tr>
<td>3</td>
<td>Meiyijia</td>
<td>Dongguan Sugar &amp; Liquor Group Meiyijia Convenience Store Co., Ltd.</td>
<td>11,659</td>
</tr>
<tr>
<td>4</td>
<td>Tianfu</td>
<td>Guangdong Tianfu Convenience Chain Limited</td>
<td>3,820</td>
</tr>
<tr>
<td>5</td>
<td>Hongqi</td>
<td>Chengdu Hongqi Chainstore Co., Ltd.</td>
<td>2,730</td>
</tr>
<tr>
<td>6</td>
<td>FamilyMart</td>
<td>Shanghai FamilyMart Co., Ltd.</td>
<td>2,181</td>
</tr>
<tr>
<td>7</td>
<td>Shizu; Zhishang</td>
<td>C&amp;U Group</td>
<td>2,003</td>
</tr>
<tr>
<td>8</td>
<td>365</td>
<td>Hebei 365 International</td>
<td>1,700</td>
</tr>
<tr>
<td>9</td>
<td>7-Eleven</td>
<td>Seven-Eleven (Beijing) Co., Ltd.</td>
<td>1,644</td>
</tr>
<tr>
<td>10</td>
<td>Quik</td>
<td>Shanghai Lianhua Quik Convenience Stores Co., Ltd.</td>
<td>1,474</td>
</tr>
<tr>
<td>11</td>
<td>Tangji</td>
<td>Shanxi Taiyuan TangJiu Supermarket Co., Ltd.</td>
<td>1,435</td>
</tr>
<tr>
<td>12</td>
<td>Lawson</td>
<td>Lawson (China) Holdings, Inc.</td>
<td>1,399</td>
</tr>
<tr>
<td>13</td>
<td>Kedi; Alldays</td>
<td>Nonggongshang Group</td>
<td>1,300*</td>
</tr>
<tr>
<td>14</td>
<td>Fook Convenience Store</td>
<td>Xiamen Fook Chain Management Co., Ltd.</td>
<td>1,237</td>
</tr>
<tr>
<td>15</td>
<td>Wudongfeng</td>
<td>Sichuan Wudongfeng Supermarket Chain Co., Ltd.</td>
<td>1,187</td>
</tr>
</tbody>
</table>

Source: China Chain Store and Franchise Association; modified by Fung Business Intelligence
*Note: Forecourt retailers
*Note: Estimated value
4. Performance of individual store improves; more players tap the online market

The performance of individual store improved significantly in 2017 with daily sales revenue increased 26% yoy to 4,936 yuan in 2017, according to the report by the CCFA and the BCG (Exhibit 5). As shown in Exhibit 6, 67% of the 55 surveyed companies recorded gross margin of over 20% in 2017, compared to 56% of the surveyed companies in 2015.

Exhibit 5: Daily sales revenue, 2015 – 2017

Source: China Chain Store and Franchise Association; BCG; compiled by Fung Business Intelligence

Exhibit 6: Gross margin of the 55 surveyed respondents of CVS, 2015 – 2017

Source: China Chain Store and Franchise Association, BCG; compiled by Fung Business Intelligence
The report also shows that 36% of the surveyed companies have set up online business (Exhibit 7), but online sales accounted for only around 8% of the total sales in 2017, slightly higher than 5% in 2016 and 4% in 2015 (Exhibit 8).

**Exhibit 7: Percentage of CVS operator going online, 2015 – 2017**

<table>
<thead>
<tr>
<th>Year</th>
<th>Offline only</th>
<th>Online and offline</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>36%</td>
<td>64%</td>
</tr>
<tr>
<td>2016</td>
<td>29%</td>
<td>71%</td>
</tr>
<tr>
<td>2015</td>
<td>25%</td>
<td>75%</td>
</tr>
</tbody>
</table>

**Source:** China Chain Store and Franchise Association, BCG; compiled by Fung Business Intelligence

**Exhibit 8: Share of online retail sales of the total sales, 2015 – 2017**

<table>
<thead>
<tr>
<th>Year</th>
<th>Offline</th>
<th>Online</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>92%</td>
<td>8%</td>
</tr>
<tr>
<td>2016</td>
<td>95%</td>
<td>5%</td>
</tr>
<tr>
<td>2015</td>
<td>96%</td>
<td>4%</td>
</tr>
</tbody>
</table>

**Source:** China Chain Store and Franchise Association, BCG; compiled by Fung Business Intelligence
II. Key trends and developments

1. O2O initiatives remain crucial

Providing pick-up services

To stay competitive in the fast-changing retail market, many CVS operators have drawn up seamless O2O strategies to attract and retain customers. Providing pick-up services in-store is a common strategy adopted by CVS players. Since the beginning of 2017, increasing numbers of CVS chains including FamilyMart, Meiyijia, Tangjiu, and Quik have partnered with e-commerce players to provide in-store pick-up services for online customers. CVS chains can benefit from the potential increase in customer flow, while e-commerce players can offer additional pick-up options for customers and enjoy lower logistics costs.

Partnering with O2O local lifestyle service platforms

Local lifestyle service O2O market in China has developed rapidly over recent years, driven by consumers’ increasing pursuit of better quality of life as well as growing demand for convenience. In the past year, many CVS operators partnered with third-party local lifestyle service/delivery platforms such as JD Daojia, Baidu Waimai, Meituan Waimai to offer O2O services. CVS players can leverage the app of these platforms to reach out to more customers, while providing other O2O services such as delivery. According to JD Daojia, as of July 2018, it has cooperated with over 10,000 CVS branches including leading CVS operators such as FamilyMart, Lawson and 7-Eleven, as well as regional CVS chains such as OurHours, Buddies, Today, Wudongfeng, Meiyijia and Youke to offer O2O services.

In August, Beijing 7-Eleven announced that all of its stores in Beijing have connected with Meituan Waimai platform. Most of the SKUs in 7-Eleven are available on Meituan Waimai platform; customers can order products via Meituan Waimai app and Meituan will provide the delivery services. It is reported that 7-Eleven will further cooperate with other delivery platforms in the future.
2. Differentiated products are the keys to success; players make greater efforts to launch private labels

Nowadays, Chinese consumers look for products that are personalized or even unique. To cater to this demand, some CVS operators have stepped up efforts to launch their own private labels and to offer such products. For instance, FamilyMart has launched its own snack food brand “YUMMY” in China; 7-Eleven has introduced its own private label series “Seven Select”; and CP Fresh Mart has launched a number of private labels for fresh produce, wine, tea, etc. Regional CVS chain Anda Convenience Store has started to sell private label products sourced from NetEase Yanxuan, an e-commerce platform under NetEase. The products are mainly daily necessities such as batteries, data cables, bandages, wet wipes, rags and cloths, bath sponges and slippers.

It is noteworthy that private label development in China’s CVS sector still lags far behind that of equivalent chains in developed countries such as Japan. According to a survey by the CCFA and BCG, over 80% of sampled CVS operators in China reported that sales of their private labels accounted for less than 10% of total sales. By contrast, for many CVS stores in Japan, private label sales account for around 40-50% of total sales. Thus, there is still huge room for private label development in China’s CVS sector.

3. Emergence of technology-driven business models

Technology advancement is a significant factor driving the growth of the CVS sector. Since the second half of 2017, there have been significant CVS initiatives involving the adoption of
technologies that can transform retail operations. This had led to the emergence of technology-driven business models including those featuring unmanned/cashierless CVS, smart shelves and smart vending machines.

Unmanned/cashierless convenience stores

Increasing numbers of players are tapping the unmanned/cashierless CVS market by launching staffless CVS, including Internet giants Alibaba and JD.com, as well as several large-scale retailers such as Sun Art, Easyhome, Rainbow Department Store, Sinopec and Lenovo (Exhibit 9). Most of these stores use advanced technologies such as artificial intelligence (AI) to replace manpower in their operations to improve efficiencies and reduce costs. A recent case is Sinopec’s Easy Joy membership unmanned store. Sinopec opened its first IC card membership-based Easy Joy unmanned store in Xiangtan city, Hunan province in July 2018. The store reportedly has adopted more than 10 technologies such as facial recognition, smart access control, electronic tags, smart lighting and scan to pay technology. In the same month, Lenovo announced that its first unmanned store has entered trial operation. Located at its own headquarters, the store provides “line-free, cash-free, and wait-free” shopping experience. It has installed devices which can detect customers’ expressions and body languages when they pick up the products in-store. It can also trace consumers’ paths and their length of stay in front of different shelves. This provides insights for adjusting product assortment and in-store display for a more convenient shopping experience.

Exhibit 9: Selected examples of unmanned convenience stores

Source: Fung Business Intelligence
Smart shelves and smart vending machines

Following the opening of unmanned stores, unmanned shelves and smart vending machines are the next wave of innovations in the CVS sector. For instance, JD Daojia has launched its unmanned shelf “Daojia Go” in tier-1 and tier-2 cities including Beijing, Shanghai, Guangzhou and Shenzhen since October 2017. “Daojia Go” shelves are mostly located in office areas. Each “Daojia Go” is a refrigerator-like box, which is equipped with facial recognition technology. After scanning their faces, customers need to scan the QR code on the “Daojia Go” app to open the shelf door; they can then take the products, close the door and settle payment instantly as the “Daojia Go” app is connected with WeChat Pay or JD Pay.

Another example is Gome. It launched its first 24-hour unmanned shelves in February 2018. Consumers need to register with the palm scanners on the unmanned shelves. Registered users can scan their palm to open the shelf door and choose the products. The system will detect the products taken out and show the product information and prices on screen. Payments will be completed via Alipay once the door of the shelf is closed. Similarly, Suning also launched its first unmanned shelve in January 2018. It is reported that Suning targets to install 50,000 unmanned shelves nationwide in 2018. The first phase will include 79 key cities in China and follow by 134 cities in the next phase.

Smart vending machine comes on the scene

Some CVS players have installed smart vending machines as a way to enhance consumer experience. In May 2018, JD Convenience Store launched a new type of vending machine in its stores across the country. All JD Convenience Store owners can put the vending machine somewhere near their stores such as outdoor sports ground and on the street. The vending machine sells mainly beverages and snacks, as well as other daily necessities, and mobile phone accessories such as power banks and screen protectors. Customers can scan the QR code on the product to complete payment. Launching smart vending machine is indeed a major attempt for JD Convenience Store to implement its “Borderless Retail” strategy – extending the retail scenes and improving user experience.

In a similar attempt to entice shoppers, domestic CVS operator Ccoop launched its first AI smart vending machine in May 2018 in Beijing. The vending machine adopts activity recognition technology and visual tracking technology to identify and detect which products have been taken out and also being put back on the rack. It is reported that the vending machine’s product identification accuracy rate is as high as 99%.
4. Retailers tap the fast-growing fresh food community store market

Launching community stores is a growing trend in the CVS sector. CVS is one of the most relevant formats for serving local communities. Instead of offering standardized products and services, CVS can better accommodate the diverse needs of different communities and provide tailor-made services for them. Specifically, CVS can provide goods and services suitable for the elderly, families, or university students in nearby areas.

Recently, some CVS chains have upgraded and transformed their stores into fresh food community stores, catering to the growing appetite of Chinese consumers for fresh, healthy, quality products. In October 2017, VIP.com launched its first offline fresh food community store “Pinjun Life” in Guangzhou. The store is operated by Pinjun Holdings Ltd., the wholly-owned logistics company under VIP.com. Pinjun Life store offers fresh food, seafood, meat and eggs, groceries, hot meals, bakery products, fast food, frozen food, etc. The store also serves as the pick-up point for online orders placed on VIP app or Pinjun Life app. According to VIP.com, it targets to open 200 Pinjun Life stores in 2018, and 10,000 stores in three years.

Another example is domestic supermarket and CVS chain operator Chengdu Hongqi. The CVS chain has further cooperated with Yonghui Superstores² to upgrade and transform some of its stores into fresh food convenience stores. Supported by Yonghui’s expertise in fresh food supply chain, the stores offer more fresh food including fruits, vegetables, meat and seafood compared to other Chengdu Hongqi stores. Chengdu Hongqi plans to open 300 more similar stores in the future.

5. Many mom-and-pop stores connect with Alibaba’s LST and JD Convenience Store

E-commerce giants Alibaba and JD.com have sought to extend their offline footprints by connecting with tens of thousands of mom-and-pop stores to help them digitalize their operations and increase their gross merchandise volume. Under its New Retail initiative, and to advance its O2O strategy, Alibaba has launched the LST “Ling Shou Tong” system to help mom-and-pop stores embark on digital transformation. The LST system provides digitalization and other business services for mom-and-pop stores in areas such as product procurement, logistics, marketing, and other value-added services. Meanwhile, the system also enables fast-moving consumer goods (FMCG) brands to connect directly with mom-and-pop stores across China that could previously only be reached through multiple layers of sub-distributors. In September 2018, Alibaba announced that it has recruited one million mom-and-pop stores or unchained CVS in China, around one-sixth of the total market, to connect with its LST system to provide

² Chengdu Hongqi signed strategic cooperation framework agreement with Yonghui Superstores in December 2017; the companies will work together in areas including supply chain management, new business expansion, logistics, technology, big data analysis, and poverty alleviation.
“one-stop solution for digital transformation” and offer better services to their local neighborhoods.

JD.com has also rolled out the JD Convenience Store initiative, partnering with owners of CVS across the country, particularly in rural areas, to help them revamp their stores. JD.com provides training, branding and products as part of a large-scale franchise model. The store owners need to pay a deposit to join the program and will retain full ownership of the stores. The JD store owners can source different types of products from JD.com including FMCG, digital products, home appliances, apparel and home furnishings. They can also source products from other retailers. JD.com intends to have 1 million JD Convenience Stores over the next five years.

*A mom-and-pop store connected with Alibaba’s LST system (Photo source: alibabanews.com)*
III. Concluding remarks

China’s CVS sector has undergone tremendous changes over recent years. Increasing numbers of players have revamped their formats by embracing O2O initiatives, developing private labels, adopting new business models, expanding product and service offerings, and adopting advanced technologies to enhance shopping experience. In our view, the CVS sector is set to continue to transform and grow in the coming years, given its eagerness to innovate and adapt to the changing needs of the market.

The growth of the sector, however, is not without challenges. Some CVS operators reflected that insufficient government support for the development of the sector in some cities has made expansion difficult. In addition, high labor costs, including turnover and training costs, as well as lack of funding remain a significant burden for many CVS players, especially the domestic ones. Meanwhile, the rise of unmanned CVS and smart shelves also pose certain challenges. First, providing excellent services is a key element of retailing; replacing manpower by technologies in unmanned stores may not be able to satisfy consumers’ demand for great service. Second, despite the rapid growth of unmanned stores and smart shelves, there have been cases of shutting down of such stores/shelves due to various reasons. Staffless smart shelf project “Gogo Small” is a case in point. “Gogo Small” reportedly shut down its 500 unmanned shelves in November 2017. According to the company, the closure was due to excessive business expansion as well as wrong choice of shelf locations. Enterprises tapping the market must be careful when devising their expansion strategies.
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