Research on the Product Pricing Strategies of Luckin Coffee

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Abstract. With the rapid growth of the Chinese coffee market over the past few decades, a number of excellent coffee brands have emerged, and market competition is becoming increasingly fierce. Understanding the pricing strategies of major players becomes crucial, especially for new brands entering the market. This paper discusses the pricing strategies Luckin Coffee adopted, the cost analysis of its products in the competitive coffee market in China, and its pricing strategies. According to the combination of qualitative and quantitative analysis, the result shows that Luckin Coffee uses a unique pricing strategy that is relatively cheaper than other brands. This is essential for attracting young and price-sensitive consumer groups. By introducing frequent discounts, Luckin Coffee successfully differentiates itself from other traditional coffee chains, thus enlarging its market share at a dramatic speed. This paper also points out the challenges Luckin Coffee faces when it offers competitive prices while remaining profitable, and how its innovative business model helps it ease this problem.

1 Introduction

1.1 Background

In recent years, with the rapid expansion of China's coffee market, consumers' demand for coffee and their purchasing habits have varied significantly. Especially, young people's coffee consumption has increased. They are attracted by trendy flavors and convenience. Luckin Coffee, which is one of the leading coffee retailers in China, occupies the coffee market through innovative business modes, extensive marketing strategies, and reasonable pricing decisions. By June 5, 2023, Luckin Coffee had 10,000 stores in the market, making it the first coffee chain in China to surpass this milestone. As of January 22, 2024, Luckin Coffee had over 13,000 stores in China and served over 200 million customers. However, due to the intensive market competition and the diversification of consumers' demand for related coffee products, how to set and adjust the pricing strategies for its products effectively becomes the main focus in order to keep competitive.

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1.2 Related research

1.2.1 Marketing and Business Strategies

According to Shang's research, Luckin Coffee has expanded at a rapid speed through its unique marketing strategies and business structure. Although it was forced to delist due to financial fraud, it managed to return to the market and achieve remarkable sales targets, facilitated by online promotion [1]. Huang argued Luckin Coffee operates in a relatively healthy market environment, which makes for its growth. However, the entry barriers of the freshly brewed coffee market have increased. Despite this, Luckin Coffee faces intense competition from substitute industries, such as the Chinese tea beverage market. Therefore, Luckin Coffee needs to improve its existing marketing strategies in order to solidify its position in the coffee market [2]. Liu said Luckin Coffee has developed swiftly and successfully gone public under the 'New Retail' model because of its reasonable pricing decisions, viral marketing, and effective brand communication and design. However, this kind of profit model involves risks since its perceived quality is not very high [3]. According to Xu, Luckin Coffee quickly rose in the coffee market in China through its innovative New Retail model, high cost-effectiveness, and aggressive market expansion strategy. On the other hand, Starbucks maintained its market position by relying on its consistent brand experience and high-quality products. Luckin Coffee's digital management and targeted advertising strategies have given it a market advantage, whereas Starbucks emphasizes its 'third place' concept and overall customer experience [4]. Sun supposed that when collaborating with other brands, Luckin Coffee not only innovates in its products but also attracts more consumers through its packaging, online and offline advertising, pricing, and peripheral products. Co-branded marketing has helped Luckin Coffee maintain a youthful and differentiated brand image, cultivate a loyal customer base, and achieve a win-win for the brand [5].

1.2.2 Market Positioning and Consumer Perception

Qiu found that Luckin Coffee has brought completely new ideas about coffee consumption. It defines coffee as a daily beverage rather than the symbols of taste or noble lifestyles, which will continue to affect Chinese dietary habits [6]. Cao believed that the success of Luckin Coffee is closely linked to its precise target market positioning. It breaks the limitation of coffee which is confined to the high-end market by making prices more competitive by using coupons. Additionally, its brand design is highly recognizable, and its use of celebrity endorsements and fan marketing strategies has effectively enhanced its brand image and market awareness. In terms of precision marketing, it utilizes big data to analyze users' behavior, delivering personalized ads. It also engages in social media interactions and offers diverse discount strategies, thereby boosting consumer brand loyalty [7].

1.2.3 Competitive Analysis

Lu discussed Luckin Coffee excels in product diversity, innovation, and market penetration, while Kudi Coffee still needs to develop a unique market strategy to enhance its profitability [8]. Liu studied that Starbucks has adopted a high-price positioning strategy, setting its pricing based on brand positioning, cost considerations, and competitive environment. Starbucks uses strategies such as skimming pricing, prestige pricing, perceived value pricing, and marginal cost pricing to maximize profits while strengthening its brand position at the same time [9].

1.2.4 Challenges

Zhu considered that Luckin Coffee faces challenges in unclear brand positioning, quality control, and supply chain management, as well as shortcomings in its price competition strategy [10]. These issues have led to market confusion, decreased brand loyalty, and damage to its reputation. To tackle these problems, Zhu proposes a diversified approach based on brand positioning, quality control, supply chain management, and innovative pricing strategies to adapt to the ever-changing market [10].

1.3 Objective

Pricing not only affects the profitability of the business but also links to consumers' purchasing decisions and brand loyalty. As the popularity of mobile payment is expected to grow, Luckin Coffee provides more cost-effective and more price-competitive coffee for consumers by combining online and offline marketing. But whether such a pricing strategy is able to attract consumers continuously remains to be seen. It is also a problem that is worth considering in depth for Luckin Coffee about how to formulate an effective pricing strategy. This paper will explore how Luckin Coffee's pricing strategies impact its market position and profitability, and examine its approach to balancing competitive pricing with maintaining quality and profitability. Besides, the paper will analyze the effectiveness of Luckin Coffee's pricing and marketing strategies in meeting the diverse demands of the coffee market and their impacts on future business practices.

2 Product positioning and cost analysis of Luckin Coffee

2.1 Product positioning

Luckin Coffee’s product positioning is deeply rooted in its understanding of the evolving needs of its target consumers, which are urban white-collar workers and young Internet users and students. They value convenience, affordability, and quality more and are more willing to try new things. This positioning enables Luckin Coffee to find its own position in the market competition, avoid the fierce situation of direct competition with traditional coffee shops, and create a distinctive brand image. Unlike traditional coffee chains that focus on creating a premium and high-end experience, Luckin positions itself as an easily accessible coffee choice. Through strict coffee bean selection, freshly ground coffee, and other measures, Luckin Coffee ensures the quality of coffee. It constantly innovates and introduces new flavors and new products to meet the diverse pursuits and freshness of target consumers. By offering a wide range of products, including coffee, tea, and other beverages, Luckin Coffee has attracted a wide audience and therefore occupies a considerable market share.

2.2 Product portfolio

Luckin Coffee’s product portfolio is designed to cater to diverse tastes, with an emphasis on affordability and convenience. Compared with international well-known brands of coffee, Luckin coffee's price is low enough to attract domestic young people's consumption. It aims to provide high-quality coffee and tea drinks, using high-quality coffee beans, with on-site brewing technology, to ensure the taste and quality of drinks. It also offers a diversity of product choices. Although the category strategy focuses on freshly ground coffee, Luckin Coffee continues to introduce new flavors and new products to meet consumers' needs for diversity. This flexibility and innovation allow Luckin Coffee to continuously attract the interest of customers and keep the brand fresh.

2.3 Innovative branding strategies

Furthermore, Luckin Coffee not only frequently introduces new and innovative products, but also collaborates with popular IPs, such as Luckin Coffee's collaboration with 'Doraemon: Nobita's Sky Utopia', which helps the business maintain a fresh and appealing image [11]. This approach not only differentiates Luckin from its competitors but also helps it cultivate brand loyalty, which is associated with innovation and value. In addition, the brand's image of Luckin Coffee is reinforced by its modern approach. Luckin Coffee uses its mobile app to simplify the ordering process, offer personalized discounts, and appeal to consumers through loyalty programs. It provides a fast and convenient consumption experience, such as online ordering, offline self-pickup, and delivery services. All of these are prepared to meet the demands of consumers anytime and anywhere. This digital-first strategy enhances the purchasing experience while locating itself as a forward-thinking brand in tune with the preferences of younger and digitally connected consumers at the same time.

2.4 Cost structure

The cost structure of Luckin Coffee is a critical factor when analyzing its ability to offer competitive pricing. The company has strategically managed its costs by focusing on several key aspects.

First, the cost can be heavily influenced by raw material costs, including coffee beans and other essential ingredients. Luckin Coffee typically imports most of its coffee beans from Brazil or Ethiopia, which are renowned for their high-quality coffee beans. According to the Daily Business News, Luckin Coffee plans to purchase approximately 120,000 tons of coffee beans in total from Brazil between 2024 and 2025. As mentioned above, if the volume of purchase is at a large scale, Luckin Coffee can negotiate favorable terms with suppliers. Hence, it is capable of keeping its raw material costs relatively low. This cost advantage is reflected in its pricing strategy, which allows it to offer products of high quality but at competitive prices while remaining profitable.

Second, production costs are part of the cost structure. The production model of Luckin Coffee is designed for efficiency. The company operates with a 'New Retail' model that combines online and offline sales channels [1]. In the era when Luckin Coffee was founded, 2018 marked the rise of 'New Retail'. Ordering delivery is a new form of retail, which is being widely accepted by the market. Luckin Coffee not only recognizes a market opportunity of 'New Retail' and its potential development in the market but also finds the increasing awareness and demand for coffee among consumers. This model allows for centralized production and distribution, reducing the need for extensive in-store preparation and lowering overall production costs. Luckin Coffee adopts the non-store retail model, through the combination of online and offline channels. It allows consumers to order online through the mobile App and the official website, with delivery directly to their doorstep by deliverymen. This innovative business model results in a more convenient purchasing experience and significantly reduced rental costs for Luckin Coffee.

Additionally, operational costs should also be involved. The operational costs of Luckin Coffee are managed by combining strategic decisions and technological innovations. The reliance on technology for order processing, inventory management, and customer engagement reduces the need for extensive human resources. This helps Luckin Coffee cut human labor costs greatly. Moreover, the store network includes a mix of traditional stores, which are pick-up stations and partnerships with third-party locations respectively. This is designed to minimize rental and operational expenses.

Marketing costs are also a significant portion of the budget of Luckin Coffee, which is allocated to marketing, particularly digital advertising and celebrity endorsements. Although these expenses are quite significant, they are integral to Luckin Coffee's strategy of rapidly building brand awareness and brand loyalty. For example, during the collaboration between Luckin Coffee and the movie 'Doraemon: Nobita's Sky Utopia', Luckin Coffee launched its annual new product, which is the Iced Coconut Latte. This drink features Luckin Coffee's new 2.0 plant-based formula, enhanced with an original cooling factor, and offers a rich coconut flavor and a refreshing taste [11]. The hue of the beverage also aligns with the collaborated IP. In addition to the themed coffee, Luckin Coffee introduced custom Doraemon cup sleeves, paper bags, and limited-edition stickers. All of these add to the product's collectibility and interestingness. Luckin Coffee also opened collaboration-themed stores in several major cities, which improved consumer engagement and brand impression. Doraemon, which is a cherished childhood memory for many people, helped Luckin Coffee resonate deeply with consumers and strengthened brand loyalty through emotional connection. Luckin Coffee uses data analytics to optimize its marketing spend, ensuring that its campaigns are cost-effective and impactful at the same time.

3 Pricing analysis

3.1 Target positioning determines the pricing strategy

The pricing strategy of Luckin Coffee mainly focuses on providing high-quality coffee at competitive prices and appealing to a broad consumer base including urban white-collar workers, students, and price-sensitive consumers. Unlike traditional coffee chains that always emphasize high-end pricing to reflect brand value and uniqueness, Luckin Coffee adopts a value-based pricing strategy. This approach allows its brand to appeal to consumers who look for affordability and quality. Luckin Coffee positions itself as a daily coffee choice rather than an occasional luxury item.

Luckin Coffee's pricing is closely related to its market positioning. The brand targets a young, tech-savvy demographic. It positions itself as an affordable and convenient alternative to traditional coffee chains like Starbucks. This position is further reinforced by frequent promotions and strong loyalty programs, which provide more price incentives to attract and retain customers.

Luckin Coffee targets consumers who are sensitive to price but pursue quality by setting a psychological price point of 9.9 RMB and using a low-price strategy [12]. Such consumers tend to focus on cost-effectiveness in their daily consumption, and Luckin Coffee perfectly meets this demand. It provides high-quality but moderately priced coffee products, attracting the brand's target groups. By providing affordable quality coffee and a wide variety of products, Luckin Coffee enables consumers to associate the brand with ‘high quality and affordable’ and ‘high cost-effective’. This strategy not only helps attract more consumers but also enhances user loyalty to the brand, further shaping Luckin Coffee's brand identity.

3.2 The competitive approach guides the pricing strategy

Compared to its competitors, Luckin Coffee's pricing strategy emphasizes accessibility over exclusivity. Since Starbucks entered the Chinese market in 1999, it has taken the leading role in the Chinese coffee market. Subsequently, although other brands, such as COSTA and Pacific Coffee, have entered the market, Starbucks maintained its dominant position for a long time. The primary coffee consumers of those brands were white-collar workers and business professionals. The price of around 30 RMB per cup was quite prohibitive for the general public [13]. Until 2018 and 2019, the emergence and rapid expansion of Luckin seemed to change this situation. Initially, Luckin Coffee's pricing was not low, but with long-term significant discounts, the actual price became quite affordable so customers formed the impression that Luckin Coffee was cheaper than Starbucks. This perception laid the foundation for Luckin Coffee's subsequent low-price strategy. Thus, while Starbucks and other premium brands may rely on higher prices to convey luxury and quality, Luckin Coffee uses lower prices to attract a large volume of sales and customer acquisition. This strategy has allowed the brand to rapidly expand its market share in a relatively short period. The low price of 9.9 RMB for a cup of coffee is very attractive to many consumers, especially in the fast-paced urban lifestyle where people often seek quick, convenient, and cheap beverage options. The price set below 10 RMB makes Luckin Coffee differentiate itself from other competitors. The cost-effective products provide the brand with a more competitive choice, which helps the brand capture a larger share of the existing market.

The low-price strategy not only helps Lucking Coffee quickly occupy market share but also implants into the cognition of consumers with the idea that you can enjoy delicious coffee for just 9.9 RMB [12]. This resonates with young people who seek emotional satisfaction, no matter whether they are happy or unhappy. Luckin Coffee has also attracted a large number of consumers through competitive prices and therefore improves its market share and visibility.

In addition, Luckin Coffee has adopted a dynamic pricing strategy to adjust prices according to market demand, cost fluctuations, and competitive pressures. For example, Luckin Coffee often offers discounts, coupons, and promotions through its mobile app, which not only boosts sales but also enhances customer loyalty. This flexible pricing model allows Luckin Coffee to remain agile in a highly competitive market, ensuring that it can respond quickly to external changes.

3.3 Cost accounting analysis

Luckin usually selects locations with high traffic and reasonable rents to open stores. Although the individual store rent expenses may be large, Luckin Coffee's extensive network of stores allows it to achieve economies of scale, resulting in lower average costs in the long run. This gives it stronger bargaining power to negotiate a lower price with suppliers. For example, in medium-sized stores, the monthly rent is about 15,000 RMB, an average of 500 RMB per day. If 500 cups are sold every day, the rental cost of making each cup is about 1 RMB.

The next major cost is labor, including baristas and store managers. In order to control labor costs as much as possible, flexible scheduling systems may be adopted to make full use of part-time employees. Assume that there are 6 employees in a store, the average monthly salary is 5,000 RMB, then the monthly labor cost is 30,000 RMB. The average total labor cost per day is 1,000 RMB. Hence, the average labor cost per cup is around 2 RMB.

Utilities, including electricity for equipment, lighting, and air conditioning, might cost about 3,000 yuan per month, averaging 100 RMB per day. For 500 cups sold daily, the utility cost per cup is approximately 0.2 RMB. Equipment costs, involving coffee machines and ice makers, are discounted due to the large purchasing volume. A set of equipment costs about 100,000 RMB and may depreciate over 5 years. The annual depreciation cost is about 20,000 RMB, which is an average of about 55 RMB per day. Through calculation, the equipment cost is about 0.11 RMB per cup of coffee [8].

The cost of raw materials, such as coffee beans and milk, is also reduced due to large-scale purchasing and the effect of economies of scale. For instance, the cost of raw materials for a cup of coffee is about 3-4 RMB. In summary, the direct cost per cup of Luckin Coffee is approximately 6.31-7.31 RMB. Even if the selling price for a cup of coffee is as low as 9.9 RMB, Luckin Coffee can still maintain a profit margin of around 30%.

4 Conclusion

This research emphasizes the importance of a well-structured pricing strategy in the success of Luckin Coffee entering China's competitive coffee market. Based on its value-based pricing model, Luckin Coffee positions itself as an affordable and convenient alternative to traditional coffee chains, such as Starbucks. By focusing on affordability and frequent promotions, it strikes a chord with young and cost-conscious consumers. Therefore, Luckin Coffee is able to grow rapidly in the coffee market. However, this study also indicates the potential risks of maintaining a low price, including the challenge of profitability and the innovation required for customer loyalty. Its future strategy should not only focus on striking a balance between competitive prices and profit margin but also utilize technology and data analytics to optimize pricing decisions, hence enhancing consumer engagement and further strengthening brand loyalty.

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