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

Jennifer Ferreira*, Carlos Ferreira

Centre for Business in Society, Coventry University, Priory Street, Coventry CV1 5FB, U.K.

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

1. Opportunities brewing in emerging markets

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

* Corresponding author
E-mail addresses: jennifer.ferreira@coventry.ac.uk (J. Ferreira), carlos.ferreira@coventry.ac.uk (C. Ferreira)

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

This article explores the growth of the coffee shop industry in China and considers both the opportunities and challenges experienced in an emerging market. We utilize the example of China in an effort to demonstrate how some businesses are navigating the new retail landscapes and highlight potential strategies for operating in these regions. We conclude by outlining a series of recommendations for developing a business in the coffee shop industry in an emerging market—and retail more broadly.

2. Emerging markets opportunities: The transformation of retail and consumption in China

Emerging markets such as China, India, and Brazil have been experiencing economic growth, changing demographics, and cultural transformations with consequent changes to the urban retail landscape (Javalgi & Grossman, 2016; Wang, 2011). The evolution of the Chinese retail sector since the 1990s is one example of this. In first-tier Chinese cities, in particular, there is evidence of convergence with international norms and trends, making Chinese retailing less distinguishable from what is available elsewhere (Uncles, 2010). New retail formats—particularly super- and hypermarkets and shopping centers—have expanded, while traditional retailing (i.e., general merchandise stores, family-owned shops, and urban markets) has declined (Wang, 2011). Wang and Zhang (2005) identified three drivers of transformation in the Chinese retail sector: (1) retail deregulation—especially lower state control over individual retailers; (2) abandonment of state monopolies and subsequent opening to private businesses; and (3) introduction of new sources of capital in the retail sector such as foreign direct investment. The latter was made possible in part by the opening of the Chinese market for foreign retailers in the 1990s, which brought in new retail formats that were quickly copied by local retailers (Wang, 2011).

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

For many industries, it is not sufficient to transfer existing business models and practices used in Western markets into these new emerging markets that require greater local knowledge of the market, its particularities, and consumer behavior (Gamble, 2010). While rapid economic growth may present opportunities for expansion into international businesses, in many cases, it also means growing domestic competition which has the advantage of a greater understanding of the national market, its consumer base, and consumer cultures (He & Wang, 2015; Talay, Townsend, & Yeniyurt, 2015). There are complexities to many of these emerging markets and different processes of business hybridization must take place (Gamble, 2010). Some international businesses recognized this and engaged in partnerships with local companies in order to break into a market, thereby acquiring an existing local knowledge base. In some cases, complexities of the market restrict businesses development and do not allow enough autonomy, and in other cases this strategy has not led to the success that was hoped for (Doherty, 2009; Khan, Lew, & Sinkovics, 2015).

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

Despite these challenges, emerging markets remain an active playing field for many international businesses and represent arenas with a rapidly transforming retail landscape that offers potential for business growth. One such retail sector is the coffee shop industry, which has been experiencing growth across all global regions but perceptions of saturation in Western markets means many future expansion plans are turning to emerging markets—particularly China, India, and the Middle East (Ferreira, 2016). The Chinese coffee shop landscape constitutes a microcosm of the dynamics of convergence and divergence of retail in China. It is dominated by Western brands (Starbucks and Costa Coffee), but it is also the setting for strong competition as Asian chains are investing heavily to gain a presence. There is evidence of local adaptation in the offerings of the various retailers. While on the margins, new providers are attempting to carve new, high-quality niches based on specialty coffee. We explore coffee shop culture in China to demonstrate how market transformation in a specific retail sector illuminates both opportunities and challenges; this is followed by a discussion of potential strategies for operating in emerging markets.

3. A growing coffee culture

3.1. Coffee consumption and the growth of coffee shops in China

According to the International Coffee Organization (ICO, 2015), the average person in China drinks only four cups of coffee a year compared with 300 in South Korea and 150 in Hong Kong, although this number is growing. The per capita data for China is heavily affected by the fact that coffee consumption is concentrated in cities and almost nonexistent in rural areas (Han & Zhang, 2009). The growth in coffee consumption and the growth of coffee shop spaces as business development opportunities has been recognized by the wider coffee and business community in China. In 2014, a strategic cooperation agreement was struck between the Food Hospitality World China (FHW) and ACA (Asia Coffee Association) to facilitate the promotion of coffee culture through FHW, one of the largest professional food associations in South China (WorldEx, 2014). This indicates the growing importance of the coffee and coffee shop sector for businesses in China. While far from being one of the largest markets for coffee consumption, China's rapid economic growth since 2000 has increased the demand for coffee, making it one of the most rapidly growing markets for coffee in the world with estimates suggesting annual growth rates of 18% until 2019 (ICO, 2015). This is, in part, a function of the rapidly expanding Chinese middle class.

3.2. A rising middle class

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

China's growing taste for foreign food and drink" (Cunningham, 2010).

These changing consumer cultures have been influenced by a number of other factors, including growing Western influences fueled by expat populations and increased Chinese mobility and tourism, as well as more traditional influences around the importance in Chinese culture of spending time with family and friends. The growth of coffee shops in China is a predominantly urban phenomenon; drinking coffee and frequenting coffee shops is considered a symbol of a successful lifestyle (Duggan, 2015). The service received in some Western chains is seen as an attraction. The service at Starbucks is considered on par if not higher than many five-star hotels. Wasserstrom (2008) interviewed several hundred consumers in Shanghai and revealed the majority actually preferred the taste of products from competitors but continued to go to Starbucks because of the service; this explains to a large extent why so many other companies have sought to replicate it.

The growth in the number of Chinese people studying abroad has increased awareness of Western brands and introduced them to experiences they wish to continue when they return home. Coffee shop culture appears to be one such experience many have become accustomed to. A study by ITC (2010) revealed that those frequenting coffee shops in China are typically 20—40 years old, Chinese, affluent, fashion conscious, and urban. Then there is the expat population in Chinese cities that also seeks a familiar experience. In 2004, it was estimated that around 30% of consumers in coffee chains such as Starbucks were Westerners and businessmen from Hong Kong, and this trend remained similar in 2013 (Euromonitor, 2013). More Chinese consumers are becoming exposed to Western influences and lifestyles. Coffee shop businesses have targeted young professionals as an audience for their products, a strategy that so far appears successful. International tourism is also an important driver of growth for the industry as a growing numbers of visitors seek to frequent familiar spaces. This growth has been linked to the rise in the hotel industry but more widely in the hospitality industry, including coffee shops (Chon, Guangrui, Lew, Ap, & Yu, 2013).

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

3.3. Functions and culture: The rise of third spaces

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

There has been significant exploration of coffee culture in Japan. White (2012) charted its history, while Grinshpun (2014) explored the consumer experience of coffee and the consumption experiences offered by coffee chains in Japan. The ICO (2015) highlighted that the evolution of the coffee industry in China over the last 10 years is comparable to the evolution of coffee demand in Japan 50 years ago. Japan has what the ICO considers an advanced coffee culture that developed over a 30—40 year period, while China is still in its early development. Patterns of growth experienced in China from 2004—2013 are similar to those of Japan in 1964—1973 in terms of coffee consumption levels; a more systematic comparison of these developments is needed (ICO, 2015), but it hints at the potential for significant market expansion.

In other well-developed coffee cultures such as the U.K., the U.S., and Australia, scholars have addressed different elements of coffee shop culture (Ferreira, 2016; Jones et al., 2015; Laurier, 2008; Laurier & Philo, 2006; Oldenburg, 2014). In other areas where coffee shop cultures are developing rapidly—including South Korea, India, and Vietnam—attention from the academic community remains sparse, suggesting there needs to be a more systematic approach to considering coffee shop cultures and their impact on urban spaces and communities. Using the Chinese market as our focus, we present a more systematic approach to researching developing coffee shop culture, one that takes into consideration the growth of the industry, the coffee shop landscape, and challenges facing the industry.

4. Coffee shops in China

The coffee shop industry in China reached revenues of $3 billion in 2016 and the number of coffee shops doubled between 2010 and 2014 (Euromonitor, 2017). China has become a growing market for international coffee shop chains as well as independents and it is clear that, as in other countries, coffee shop culture in China is about much more than just coffee. Overall, the Chinese coffee shop market remains consolidated with international chains dominating. In 2010, Starbucks had a 66% market share in the coffee retail sector (Barlow, 2013). However, this image is set to change as competition from different types of coffee shop spaces and business models emerge to occupy different segments and niches of the market. The coffee shop landscape in China shows the hallmarks of the three waves of coffee often referred to in the industry: (1) the growth of coffee consumption with the appearance of instant coffee; (2) the rise of coffee shop chains and espresso-based drinks; and (3) an increase in consumers treating coffee like an artisanal product and seeking to understand more about coffee, its origins, and brewing methods (Ferreira, 2016). Given these changes in the Chinese market, we identify five phases in Chinese coffee culture that align with the three waves (see Table 1).

4.1. First wave of coffee: Home and fast-food outlets

China has a tea culture that dates back over 2,700 years. Ingrained in Chinese society, "tea culture

Table 1. Timeline of Chinese coffee and coffee shop culture

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

covers almost all realms of life, both physical and spiritual" (Xiusong, 1993, p. 89). Tea is not only an everyday good for consumption but has been integrated into many ceremonial and social occasions in Chinese society (Hinsch, 2015; Wang, 2012a). Although China is still predominantly a tea-drinking nation, evidence suggests a developing taste for coffee. While tea drinking has a rich symbolic history, coffee drinking in modern China is seen as more of an indicator of a successful lifestyle, a symbol of the Western world (Han & Zhang, 2009).

The Chinese coffee market is dominated by instant coffee (99% of retail volume), although roasted coffee's popularity is growing (ICO, 2015). Instant coffee is viewed as an inexpensive beverage that, while it is of lower quality, serves its purpose as the afternoon workplace keep-everyone-awake beverage (Barlow, 2013). Nestlé remains the forerunner in this market, and the brand name has been adopted by many as the generic name for coffee, retaining around 68% market share in 2009 followed by Maxwell House with 14% (ITC, 2010). Instant coffee is the only coffee available to many, due to cost and availability. Furthermore, some coffee shops will go to great efforts to produce high-quality advertising to indicate they are serving high-quality coffee, when in fact it is just highly priced instant coffee. The promotion of the fresh roasted and ground coffee market is the catalyst in the transition from instant coffee consumption in the home to ground coffee out of the home. Growth in coffee consumption was initially concentrated in first-tier cities, but now consumption is expanding rapidly in second-tier and third-tier cities where urbanization has been rapid over recent decades; coffee is now expected to become a significant market across a range of Chinese cities (Barlow, 2013).

Coffee consumption out of the home has largely been attributed to growing outlets in fast-food restaurants with U.S. chain McDonald's playing a predominant role. In 2009, McCafés began appearing in existing McDonald's restaurants, providing the new refreshments to go. The company began to adopt a less-is-more design strategy for its restaurants, including armchairs and more gentle colors designed to encourage customers to stay and enjoy the environment. It even introduced a new motto, Make Some Room For Happiness, that built upon I'm Lovin' It (Reuters Staff, 2010). By the end of 2013, McDonald's had 660 McCafé stores in more than 25 Chinese cities with plans to accelerate store expansion, which would lead to the creation of 2,000 jobs in these outlets (Shimada, 2015). Like Starbucks, which faced public backlash for locating in the Forbidden City, McDonald's faced a similar response when it opened a McCafé in a historic building in Hangzhou, reiterating the point that while the presence of Western-style consumerism may be welcomed by some and in some locations, this does not apply to all cases or areas (Lu, 2015) and care should be taken when selecting a location.

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

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

4.2. Second wave of coffee: Dedicated coffee chains

4.2.1. The major coffee chains

Two brands dominate the European and American chain coffee shops present in China—Starbucks and Costa Coffee. Starbucks, the U.S.-based international coffee shop chain, opened its first store in China in 1999 in the Chaoyang district in Beijing and by 2015 had a network of over 1,700 outlets in over 90 cities, making it one of the largest markets for the business (Kelly, 2017). While Starbucks continued to close some of its stores in the West, it continued to expand in Asia. In 2012, Starbucks announced China was to become its largest market outside of the U.S., with over 500 outlets that were more profitable per outlet than in the U.S. (Rein, 2012). In 2013, Schulz acknowledged that China had the potential to become the largest market in the future, as the company sought to expand across tier 1—tier 4 cities (Barlow, 2013). By 2017, Starbucks had 2,800 stores in the country and announced an ambitious plan to have 5000 stores by 2021 (Kelly, 2017).

Initially, Starbucks targeted expats and tourists but increasingly paid attention to local consumers as coffee drinking and frequenting coffee shops rose in popularity. Starbucks in China targets consumers in the upper income levels as drinks tend to cost around 50% more than in their U.S. stores; typically, a drinks costs from 30 RMB (USD $5). This compares to instant coffee such as Nestlé which can cost as little as 1.5 RMB (USD $0.10; Barlow, 2013). Consumers in China pay a premium at Starbucks for the coffee shop experience, conforming to the idea that some Western brands are considered aspirational.

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

The Starbucks menu also reflects local tastes, including green tea tiramisu and Chinese moon cakes. These efforts might be associated as a feature of *glocalization*: adapting a global brand to a local culture (Svensson, 2001). Starbucks has positioned itself as an aspirational brand, and largely succeeded to expand in a market where other Western brands—including Dunkin Donuts, Krispy Kreme, and Burger King—struggled (Wang, 2012b). Success was in part attributed to its adaption to the local tastes (Rein, 2012): "Instead of trying to force onto the market the same products that work in the U.S. like regular coffee, Starbucks developed flavors, such as green tea flavored drinks, that appeal to local tastes."

Starbucks recognized that the potential expansion places were different, not only from other international markets but also within China. In Shanghai, the existing competitors were a mix of traditional tea houses, Japanese-style coffee houses, as well as coffee shops designed to evoke memories of 1920s and 1930s Shanghai when the city was seen as the heavily Westernized Paris of the East (Wasserstrom, 2007). To enter Shanghai, Starbucks partnered with the Taiwanese firm Presidential Coffee. The logic was that a partnership with Presidential would allow greater knowledge of the market, as they had previously been successful in helping to introduce 7-Eleven stores to the Philippines (Wasserstrom, 2008). Starbucks was presented as a European-style coffee shop in the local media and an alternative to Manabe, the Japanese chain that entered Shanghai in the 1980s (Cunningham, 2010). In June 2011, Starbucks signed an agreement with Maxim Group, its long-term partner, to take over 100% of its ownership in certain provinces and in 2017 bought out any remaining joint venture partners to ensure full ownership of stores in China (BBC, 2017).

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

Another Western coffee shop chain seeking to capture the Chinese market is Costa Coffee, the U.K.-based wholly-owned subsidiary of Whitbread, which entered China in 2006 and by 2013 accounted for 8.9% of the coffee market. By 2017, Costa had 350 stores in China (Gerrard, 2017). To break into China, Costa Coffee entered into a joint venture in Jiangsu Province. The logic behind such a partnership is that the Costa Coffee brand—on its own as a new entrant to the market—would take a long time to establish itself, whereas a local company with a knowledge of the market and its customer base could more quickly establish the brand. Costa was initially heavily dependent on its partner, particularly to drive the business. Costa also entered into a joint venture agreement with Beijing Huilan Group, a leading Chinese retailer, in order to expand into high-end business complexes via retailers, supermarkets, department stores, and shopping malls. In 2017, it was announced that Costa was to buy out one of its joint venture partners (mirroring some of the activities of Starbucks), and also had ambitious expansion plans for 700 stores by 2020, which would still place it significantly behind the market leader (Gerrard, 2017).

4.2.2. The challenger coffee chains

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

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

In 2015, Gloria Jean's Coffees, a large global coffee house chain originating in Australia, announced it would attempt to expand in the Chinese market, partnering with the Chinese restaurant group Gou Bu Li, which operated a few existing Gloria Jean's stores (SBS, 2015). The Coffee Bean & Tea Leaf, a Los Angeles-based company, intended to open 700 stores in China in coordination with the South Korean retail conglomerate E-Land Group, a company that already owned an operation of over 60 fashion brands in Korea and 11 brands of hotels with a history of operating international brands in Asia (Brown, 2015).

4.2.3. Emerging domestic challenger coffee chains

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

Some domestic chains have attempted to capitalize on the Starbucks model. An extreme example is Shanghai Xingbake coffee, which had a logo featuring a bold green circle, not too dissimilar from the Starbucks logo. Starbucks successfully sued Shanghai Xingbake for copyright infringement in 2006 (BBC, 2006). The Chinese domestic chains tend to pay more attention to the environment provided to consumers rather than the coffee itself, playing on the romantic image of the old world roaster (Wasserstrom, 2008).

4.3. Third wave of coffee: Specialty coffee shops

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

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

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

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

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

5. Opportunities and challenges for coffee shops in China

Our analysis has shown the vibrancy and dynamism of the coffee shop industry in China. This suggests opportunities for growth across the market; however, the analysis also suggests challenges ahead. This section details these challenges and looks at the landscape of internationalization of coffee shops in emerging markets more generally.

5.1. Opportunities for growth

5.1.1. Major coffee chains

For the major coffee chains (Starbucks and Costa), the Chinese market offers continued opportunities. Seen as luxury brands and associated with affluent and urban lifestyles, these companies are able to sell their product at price points that allow them to be profitable. In turn, that profitability could help the companies expand further. This capacity to finance rapid expansion is important at a time when both companies find themselves in charge of their own strategies due to the (1) the unraveling of local partnerships and (2) the lack of development of the Chinese franchising market.

Having partnered with local businesses in order to enter the market and gain local knowledge, both Costa and Starbucks have now ended such partnerships because they inhibited them from expanding at the pace and in the style they wanted to. This should allow each of the companies to focus on its values, products, and image, rather than seeing them potentially diluted by local partners with different agendas. Although it has not worked as well in China, the franchise model is used in the Western markets by these coffee shop chains. While the franchise model typically allows foreign companies a low-cost rapid growth model, providing easy access to a new consumer market with faster brand recognition, China's franchise culture is not well developed. As a result of these trends, Starbucks and Costa have an opportunity to consolidate their position as aspirational brands and continue to sell their products at a high price point rather than becoming commodified.

5.1.2. Challenger coffee chains

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

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

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

5.1.3. Specialty coffee shops

Following the trends observed elsewhere in the world, China has seen the emergence of the first few third wave coffee shops. Characterized by an interest in quality and the methods of sourcing and brewing coffee, third wave specialty coffee shops also offer differentiation and new experiences for the discerning consumer. Their emergence suggests the Chinese coffee shop industry is not only growing quantitatively but is also experiencing differentiation with the appearance of a new segment of consumers who have both interest and buying power, and therefore a range of potential opportunities for growth.

In part to support this growing taste for coffee, there is also a burgeoning coffee growing industry, particularly in the Yunnan region that is developing an international reputation for its specialty coffee (Wang & Newton, 2016). Such growing tastes for coffee are likely to fuel the existing expansion of the coffee shop industry and provide a more diverse business base for the industry. With the right business strategies, there is room for significant growth in this sector for both international and domestic companies that can cater to a diverse consumer base developing beyond the urban middle class; such strategies have the potential to be transferred to other areas of the retail sector or to other emerging markets. Despite these opportunities, the sector also faces important challenges. Section 5.2. addresses these.

5.2. Challenges to growth

5.2.1. Major coffee chains

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

Continued growth is reliant on the expansion of the middle class, but also diversification of activities to cater to the needs of different consumer groups. While in Europe drinking coffee in a coffee shop may be an everyday activity, in China it remains a premium activity that is out of the average worker's reach. The high price of coffee in many international coffee shop chains excludes many consumers, but may provide an opportunity for the domestic coffee shops. Many Chinese consumers simply cannot afford to adopt the Western habit of drinking in coffee shops under the current price models (Yingzi & Zhouqiong, 2015). The prices of espresso-based beverages are higher in China than in the U.S.: where a Grande Latte at Starbucks costs around USD \$3.75 in the U.S., the same drink would cost almost USD \$4.50 in Beijing. To add to this price difference, the income of city dwellers is also lower than that of the U.S. With high prices and lower earnings, fewer people are able to afford a daily coffee habit, choosing instead to drink bottled teas and juices; this highlights that coffee shops may wish to consider the range of products they offer to attract a wider consumer base.

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

5.2.2. Challenger coffee chains

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

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

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

5.2.3. Specialty coffee shops

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

5.3. Internationalizing coffee shop retail in emerging markets: The importance of coffee culture

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

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

6. Strategies for future growth and a future research agenda

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

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

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

The third recommendation involves segmentation. Different segments begin to emerge as the market for coffee develops, sometimes changing the position of brands and companies. While Starbucks and Costa remain key players in the Chinese coffee shop market, they now face competition from a segment offering arguable value (challenger chains), as well as a higher, more luxurious offering from specialty coffee shops. As a result, the majors risk finding themselves offering a commodity product and experience, while being perceived as lower value due to higher prices. Businesses looking to internationalize should observe the results of their efforts to develop markets. In particular, they should consider regional variations within the market and consider the demographics and consumer cultures associated with the different regions. In addition, future business models should consider incorporating price differentiation of products and services in order to target a broader spectrum of consumers. Businesses also need clear strategies for how to serve customers in those markets; in the coffee shop industry—as in other areas of retail—there are niches to be explored. For those in the coffee industry, this could be the addition of a barista training school (which also provides courses for consumers), an in-store roastery (to provide more of a sensory experience in the coffee shop), or focusing on a particular theme to differentiate the business from others (e.g., board game cafes and cycle cafes have been popular in some countries).

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

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