

China's On-demand Delivery Sees Rising Demand

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Online groceries will be one of the major growth drivers of the overall e-commerce industry in China. With China's e-commerce penetration reaching 35%, analysts expect further growth in the low teens over the next three years.¹ While online penetration is high for certain product categories like home appliances (44%) and beauty and personal care (39%), the penetration rate for online groceries is only 15.7%.^{2,3} On-demand delivery has been a rising star in online groceries this year, and we expect this business to sustain its robust growth in the coming years. For investors, we believe this shift presents a compelling opportunity to capitalise on the competitive advantages of leading food delivery players as they grow their presence in the on-demand delivery space.



KeyNotes

- On-demand delivery businesses are emerging as a key driver of online grocery sales growth across China.
- The penetration of on-demand delivery still has significant headroom for growth, representing just 2-3% of total grocery sales in China.⁴ We expect the channel to sustain robust growth, driven by changing consumer habits, focused investment from e-commerce players, value-added benefits for merchants, and government support.
- Leading e-commerce and food delivery businesses that can leverage existing rider networks have a strong competitive advantage to lead in the on-demand delivery segment

On-demand Delivery to Drive Growth of Online Groceries

Since the pandemic, major e-commerce players have invested heavily in their Community Group Purchase (CGP) businesses as consumers shifted to purchasing groceries online. However, the growth of CGP businesses has slowed down this year partly due to government regulation. Large platform companies were found to be selling grocery products at significantly discounted prices, sometimes even at a loss, mainly to gain market share. These pricing tactics competed not only with other e-commerce companies but also directly with small mom-and-pop stores, leading to the government's intervention.

¹ Source: Morgan Stanley, July 2022

² Source: Euromonitor, Morgan Stanley, July 2022

³ See our [previous note](#) which touched on why e-grocery penetration has been lower than other categories

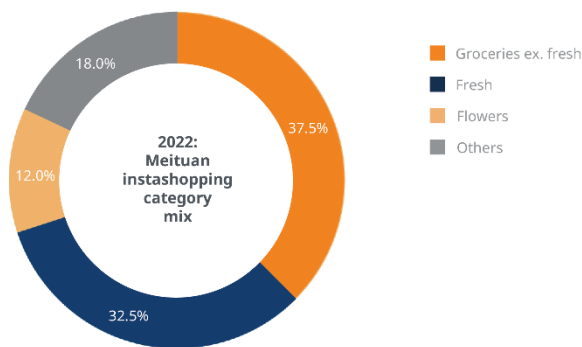
⁴ Source: Bernstein, August 2022

Since then, companies have gradually shifted their focus from CGP to on-demand delivery businesses. For example, Meituan, the leading player, has focused less on its CGP business (Meituan Select) over the past year and is now focusing more on its on-demand delivery business (Meituan Instashopping). The company has even reclassified its segmentation disclosures by shifting Meituan Instashopping from “new initiatives” to “core local commerce” along with its food delivery, in-store, hotel, and travel businesses.

On-demand delivery has shown a robust growth rate, with a large part of the sales mix coming from grocery products like fast-moving consumer goods (FMCG) and fresh products.⁵ Globally, on-demand delivery businesses are facing challenges with the rising cost of capital. However, we believe that Chinese companies can leverage their moats in food delivery to sustain high growth rates in on-demand delivery businesses and become profitable in the near future. Key success factors of China’s food delivery industry include the country’s high population density and lower rider costs compared to other developed economies. By applying this same logic to on-demand delivery businesses, we expect this service will be a leading driver of China’s online grocery growth in the years to come.

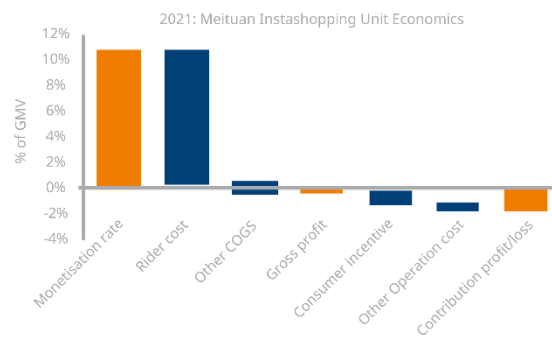
Fresh Goods and Other Grocery Items Account for c. 70% of GMV

Source: Industry interviews and Bernstein analysis, as of 2 August 2022



According to Meituan, Instashopping Losses Currently Strand Around 1-2% of GMV

Source: Corporate reports, Bernstein estimates and analysis, 2 August 2022



Low Penetration Provides Headroom for Grow

China’s penetration of on-demand delivery is currently low, representing just 2-3% of total grocery sales and around RMB 254 billion in gross merchandise value (GMV) across the top players in 2021.⁶ For the leading player, Meituan, analysts estimate Instashopping’s GMV was RMB 87.6 billion in the four quarters ending March 2022.⁷ However, these figures are nascent when compared to industry forecasts. Meituan’s management, for example, believes that on-demand retail in China could grow to become at least an RMB 1 trillion market.

Despite the low penetration rate, on-demand delivery is already a meaningful channel for leading supermarkets. According to Bernstein, on-demand delivery represented around 18% of revenues for the top 20 supermarket chains in China.⁸ Thus, we expect on-demand delivery to sustain robust growth and take a greater share of China’s overall grocery market, supported by several key drivers:

⁵ Source: Bernstein analysis, August 2022

⁶ Source: Bernstein, August 2022

⁷ Source: Ibid.

⁸ Source: Ibid.

- **Changing consumer habits:** Many consumers relied on on-demand delivery services during the lockdowns in China this year. After trying the service, many consumers are willing to pay a premium for the extra convenience. In addition, younger consumers tend to have a higher willingness to pay for convenience, especially in China, where like other major Asian countries such as Thailand, Taiwan, Japan, and Korea, we see high penetration of convenience stores.
- **Investments by e-commerce companies:** As mentioned above, platform companies are shifting their investments to on-demand delivery businesses. In particular, the focus is on the grocery category, where online penetration remains low and presents ample growth opportunities.
- **Value add for merchants:** More merchants are willing to join on-delivery platforms as the service provides incremental revenue with delivery enabling larger catchment areas. While the top 20 supermarket chains already have 18% of their revenue from on-demand delivery, this figure is still tiny for smaller merchants and has significant room for growth.⁹ Moreover, on-demand delivery is not only for grocery products but also extends to flowers, consumer appliances, pharmaceutical products, etc. For Meituan, Instashopping increased the number of new merchants by more than 30% year-on-year in 2Q22.¹⁰
- **Government support:** The Chinese government supports on-demand delivery as the business model helps digitise small- and medium-sized merchants. But, more importantly, on-demand delivery supports small and medium enterprises (SMEs) rather than taking shares from them, which was the case previously with the CGP model.

Leading Platforms Have a Head Start in the On-demand Delivery Segment

We believe leading e-commerce names like Meituan, JD, Alibaba, and companies with strong food delivery businesses have natural moats to win the on-demand delivery market, considering they can leverage their delivery rider networks. Thus, it's no surprise that Meituan, with a 70% market share in the food delivery market¹¹, is also the leading player in the on-demand delivery segment, with a 30% market share.¹² The company is targeting 10 million orders per day for its Instashopping business, compared to 100 million orders per day for its food delivery business by 2025. To put this into context, Instashopping already reached an average of 4.3 million daily orders in 2Q22.¹³

Most players are currently loss-making. Thus, considering unit economics, we think players with food delivery businesses may continue to gain market share while front distribution centre models like Dingdong and Missfresh will lose.

⁹ Source: Bernstein, August 2022

¹⁰ Source: Company data, August 2022

¹¹ Source: Morgan Stanley, May 2022

¹² Source: Bernstein estimates, August 2022

¹³ Source: Company data, August 2022

Comparison of Key on-demand Delivery Marketplace Players

Source: Company data, Snowball Finance, Morgan Stanley Research estimates, July 2022

	Meituan Instashopping	Ele.me	JDDJ
Business model	Marketplace model providing non-food on-demand delivery service	On-demand delivery business, supported by Fengniao Logistics	Online marketplace platform, one of largest local on-demand retail platform
Product categories	Strength in medical products, and flowers, with expansion into higher ticket-size categories such as computer, communication, and content (3C)	All categories, strength in daily necessities	Strength in supermarket, fresh produce, pharmacies, flowers, bakeries, and fashion stores
Coverage	2,800 cities and counties	2,200 cities and counties	1,400 cities and counties
User base	230mn ATU	28% yoy growth Ele.me MC for 12M ended September 2021	41.3mn ATU
GMV	NA	NA	Rmb43bn (2021)
Order Volume	Daily order volume of 3.7mn (4Q21)	+35% yoy on-demand order growth for 12M ended September 2021	Daily order volume of 0.6mn (2021)
AOV	~Rmb70 (4Q21)	NA	Rmb190 (2021)
Monetization rate	NA	NA	94% (2021)
Customer incentives	NA	NA	5.4% (2021)
Profitability	-1.8% OPM (4Q21)	NA	-3.9% OPM (2021)

Meituan achieved profitability earlier than guided in 2Q22, thanks to lower incentives and rider costs during the lockdown. Meituan's management indicated that they will spend more in 2H22 as it is still at an early stage of industry development and would prioritise growth over profitability. Yet, the company has already proved that on-demand/food delivery businesses can be profitable in China. While we believe there will be various business models to drive the online grocery market in China, we expect that on-demand delivery will be a major growth driver.

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