

# Avoiding the Caffeine Crash:

## A Strategic Analysis and Recommendations for Starbucks



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## Executive Summary

On a mission to caffeinate the world, Starbucks set out to establish itself as the “most recognized and respected brand” (Starbucks, “About Us”). Starbucks appears to be well on its way to achieving this goal having seen astonishing success in recent years and becoming an international symbol for not only coffee, but for growth. Starbucks had what it believed to be a recession-proof product as during the post-9/11 recession, while other retailers were being hit hard, Starbucks was experiencing its 11<sup>th</sup> consecutive year of 5% or higher comparable store sales growth (Moon and Quelch). However, with collapse of the housing bubble in the United States, the economy is once again on the downswing and consumers are pinching pennies. The coffee giant will not be able to walk away from this battle unscathed as Starbucks began to show signs of weakness for the first time, in January 2009 when the company announced that it would close 900 stores worldwide (Flynn).

The following report is an evaluation of the key issues facing Starbucks and the specialty coffee shop industry as a whole. Recommendations are then provided for the strategic direction Starbucks should follow in order to face these challenges head-on and stay on top.

### Key Issues

The year 2010 will pose a variety of obstacles for this caffeine giant:

- How should Starbucks move forward with its growth strategy during a time of economic downturn in the US?
- As consumers become more price sensitive and look to cut down on expenses, how should Starbucks aim to prevent demand for its more expensive, handcrafted specialty coffee beverages from falling?
- How should Starbucks confront competition from low-cost “premium” coffee beverages from fast-service food chains like McDonalds and Dunkin’ Donuts?
- How can Starbucks revive its image as a brand that puts people first, not profits?

### Recommendations

**Pursue VIA:** Starbucks should aggressively promote its new soluble coffee product VIA. This product represents a large opportunity for the company by capturing price sensitive customers in hard economic times and by allowing the company to make a move in an untapped market for high quality instant coffee. Furthermore, VIA has great potential internationally, where instant coffee continues to be very popular.

**Promote Customer Rewards:** Starbucks should put more emphasis on its newly consolidated customer rewards program, “My Starbucks Rewards”. With the US economic crisis, customers are cutting down on excess expenses including specialty coffee beverages. Starbucks should advertise its new free rewards program as a way for customers to save money without having to sacrifice their trips to the coffee shop.

**Free Internet:** Recently Starbucks’ image as a community environment has suffered as a result of the company’s aggressive growth strategy. In an effort to go back to the basics and encourage customers to stay and enjoy themselves, Starbucks should offer free internet. As customers feel welcome to enjoy their coffee and stay around to get some work done, the company will be renewing its image. Furthermore, as customers stay longer they are likely to purchase more beverages and same store sales, a critical performance metric for the company, should increase.

## Business Level Strategy

**Goals:** The goal at Starbucks is to create added value by offering the customer something more than a simple cup of coffee. Delivering what the company refers to as the “Starbucks experience” involves quality coffee, customer intimacy and a community ambience that makes the customer want to sit down and stay a while.

**Scope:** Traditionally, Starbucks has catered primarily to affluent, well- educated, white-collar patrons (skewed female) between the ages of 25 and 44 (Moon and Quelch). However, recent market research has revealed that the client base at Starbucks is changing: “Starbucks’ newer customers tended to be younger, less well-educated, and in a lower income bracket than Starbucks’ more established customers” (Moon and Quelch). These customers tend to be more price-sensitive and are more likely to reduce their specialty coffee purchases during economic hardships.

**Competitive Advantage:** Starbucks’ competitive advantage stems from its ability to differentiate itself as the leading premium brand in specialty coffees. Starbucks looks for ways to add value for the customer, creating the “third space” envisioned by the founder as a haven between home and work or school. Starbucks has a number of resources that contribute to its competitive advantage, from its friendly and knowledgeable baristas, to owning much of its supply chain, to its wide distribution network. These resources, as well as Starbucks’ position as the industry leader in specialty coffee shops, create barriers for other competitors that help Starbucks maintain its leadership position.

*For more on Starbucks’ competitive advantage refer to “Resources and Competitive Advantage” in Appendix B.2*

**Economic Logic:** Starbucks has focused on adding value to what was previously considered a commodity. By creating an upscale atmosphere and offering high-quality coffee, Starbucks is able to command a premium price for its handcrafted beverages. Forming alliances with suppliers and

ultimately controlling much of its supply chain allows Starbucks to ensure quality and consistency in its products.

### **Threats**

- ***The Economic Downturn in the US:*** Starbucks' premium-priced coffees are considered luxury goods to most consumers and are therefore vulnerable to fluctuations in consumer income. The collapse of the housing bubble in the US has had a damaging effect on the specialty coffee industry as a whole.
- ***Increasing Competition from Quick Service Restaurants:*** Quick service chained restaurants like McDonalds and Dunkin' Donuts have recently made moves into the specialty coffee niche, introducing their own lines of "premium" coffee and espresso beverages. These chains offer their products at lower prices and additionally offer consumers the possibility for a cost-effective "one-stop-shop" for breakfast and coffee beverages. As the economy in the US is on the downswing, the threat from these competitors is great as consumers look to eliminate excess costs and trade down to lower cost alternatives. Starbucks has responded to this threat in part by introducing new food items to its menu as well as a lower-cost soluble coffee product VIA. See "opportunities" below for more information.

### **Opportunities**

- ***New Products and Expanded Menu Offerings:*** Starbucks has looked to counter moves by fast food chains like McDonalds on its core specialty coffee market by advertising new food items and a value meal of its own: for \$3.95, customers can order a coffee and an egg sandwich, cup of oatmeal or coffee cake (Miller). These new products have the potential to attract new customers who are looking for a fancier or more healthy breakfast and at the same time, at under four dollars, the new meal appeals to value conscious consumers. Meanwhile, in a further effort to recast itself as an affordable brand, Starbucks has launched VIA a new instant, soluble coffee product that has the potential to appeal to customers who are looking to save money in difficult economic times.
  - VIA is a product that represents a large opportunity for Starbucks as instant coffee is currently a \$21 billion dollar market that most specialty coffee chains have not dared enter (Baertlein). VIA will not compete directly with established instant coffee brands like Nestle and Taster's Choice, rather will occupy new market space as a premium product that will sell for a price somewhere between handcrafted specialty beverages and lower-quality instant coffees.
- ***Expanding Coffee Culture:*** Coffee culture is not only expanding in the US, but in many countries around the world. Starbucks' position as a leader in specialty coffees presents the opportunity for first-mover advantages as the company should not have difficulty replicating its model in locations across the globe. China appears to be one of the countries where there is a large

opportunity and a relatively undeveloped market for specialty coffee beverages (Euromonitor, “Starbucks Corp in Consumer Foodservice”).

*For more on threats and opportunities see the section on External Analysis in Appendix A.*

## Corporate Level Strategy

**Goals:** The overarching goal for the company is to “establish Starbucks as the most recognized and respected brand in the world” (Starbucks, “About Us”). An important part of the beliefs system also includes a dedication to putting “people before products” (Starbucks, “About Us”).

**Scope:** Starbucks’ core business lies in its company-operated retail stores; however the company engages in a number of other complementary activities including: foodservice contract and contracts with licensed partners, such as Kraft, Pepsi-Cola and SYSCO, who help distribute the company's branded coffees, teas, ready-to-drink beverages and other merchandise to grocery stores, warehouse stores and convenience outlets worldwide (B&C Resource Center, “Starbucks Corp”). Starbucks operates in nearly 40 countries and as of September 2009, the company operated more than 8,832 company-owned retail stores (6,764 in the U.S. and 2,068 internationally) and distributed products through an additional 7,803 licensed retail outlets (4,956 U.S. and 2,847 international) (B&C Resource Center, “Starbucks Corp”). Starbucks brands also include Seattle's Best Coffee, Tazo teas and Frappuccino (B&C Resource Center, “Starbucks Corp”).

**Competitive Advantage:** In an effort to achieve its goal of becoming the most recognized brand in the world, Starbucks aims to reach customers not only through its coffee shops, but in the grocery stores as well. Often Starbucks has found that licensing its brand to third parties who share the company’s values and dedication to quality is a good way to attract new customers and familiarize them with the name Starbucks. In fact, about 40% of new customers at Starbucks’ stores have already tried the Starbucks brand in the less-intimidating grocery store environment before they ever set foot in a coffee shop (Moon and Quelch). The combination of these products with the company-operated stores help Starbucks maintain its leadership position as the top brand in specialty coffee products by reaching a much broader consumer base than it would with coffee shops alone.

**Economic Logic:** Since licensed goods count for only a small portion of Starbucks’ revenue (just 4% in 2008), it makes sense for Starbucks to engage in partnerships with third parties, rather than invest the time and resources into creating and marketing the product themselves (Euromonitor “Starbucks Corp”). This allows third parties to use their competencies to effectively create and market quality products that bear the Starbucks brand, while Starbucks uses its resources to focus on its core business of operating specialty coffee shops. Although, these products do not contribute a significant portion of the company’s revenue, they are indispensable for creating brand awareness and customer loyalty.

**Strengths:**

- **Leadership Position:** Starbucks is the only nationwide brand that operates exclusively in the specialty coffee niche.
- **Starbucks Experience:** Starbucks has created a unique value proposition for customers offering a “third space” community environment between home and school or work.
- **Alliances with third parties:** Starbucks works with third parties to create quality products that bear the Starbucks names in other outlets such as grocery stores.
- **My Starbucks Rewards Program:** In January 2010 Starbucks introduced a new rewards program that is free to enroll and offers members rewards based on the number of purchases they make. This program works with the very popular Starbucks gift card that is already involved in about one out of every seven transactions (“Starbucks to Add to Popular Prepaid Card Program”).

#### **Weaknesses:**

- **Market Saturation Strategy:** Starbucks has expanded so rapidly and focused on having a high concentration of stores in the areas where it operates. When the economy was good, Starbucks did not need to worry about self-cannibalization to a great extent; however, with the economy floundering Starbucks is starting to feel the need to cut costs and eliminate stores that have too much overlap with other stores.
- **Effect of Growth on Brand Image:** Starbucks’ rapid growth has had some negative impacts on brand image. Many consumers feel that Starbucks has lost its focus on people and has become nothing more than a giant corporation hungry for higher profits.
- **Dependence on US Market:** The majority of Starbucks’ outlets are found in the US. Starbucks has been very vulnerable to changes in consumer spending as the economic crisis in the US drags on.

*For more on Starbucks’ strengths and weaknesses see Appendix B.*

## **Recommendations**

**Pursue VIA:** Starbucks should continue to push its new soluble coffee product, VIA. In the short-term, VIA could help Starbucks gain back some of its brand-loyal customers who are looking to cut costs. In the long-run, VIA represents a substantial opportunity for the company as it occupies new market space and has the potential to be a disruptive innovation in the specialty coffee industry. Furthermore, VIA should be pushed internationally where instant coffee still tends to dominate the market.

*For more on VIA see “Threats and Opportunities” in Appendix A.4*

**Promote Customer Rewards:** While the US economic crisis is having customers looking for ways to save money, pushing the company's new rewards program could be an effective way to keep customers from cutting out their trips to the coffee store. Starbucks should aggressively advertise its newly introduced "My Starbucks Rewards" program as a way to save money while still enjoying life's little luxuries. Starbucks should have baristas inform customers of the changes to the new free rewards program and actively encourage customers to enroll. Pushing the rewards program is another way for Starbucks to recast itself as an affordable quality brand.

**Free Internet:** In an effort to reinforce its image as a community centered brand, Starbucks should refocus its efforts on encouraging customers to stay around longer. Offering free internet is a way to make it easier for customers to enjoy their coffee and get work done. Price sensitive customers, like students, would be willing to stay longer and likely purchase more beverages. At the very least, free internet would boost Starbucks' weakening brand image and remind consumers that the company's interests really are "people first".

## Appendices

### Appendix A: External Analysis

#### *Industry Definition:*

Starbucks Corporation engages in several diverse business activities; however, the company's core business falls within the large category of Consumer Foodservice. Within this broad industry, Starbucks operates and dominates the coffee shop niche (IBISWorld). To define the market even further, Starbucks focuses on the sale of high-quality, specialty or gourmet coffees.

#### *Key Players:*

**Starbucks** is by far the leader in the Specialty Coffee Industry with a presence in 49 countries and 16,342 outlets worldwide in 2008 (Euromonitor, "Starbucks Corp in Consumer Foodservice").

Major competitors within the specialty coffee niche include:

- **Caribou Coffee:** has more than 500 company-owned stores located in 16 states in the US and several locations worldwide (Caribou Coffee, "Company Information").

- **Costa Coffee:** has a presence in 28 countries, with consistent outlet growth, reaching 1,073 units in 2008. (Euromonitor, “Starbucks Corp in Consumer Foodservice”)

On a broader scale, Starbucks is the sixth largest brand within the Consumer Foodservice Industry (Euromonitor, “Starbucks Corp in Consumer Foodservice”). Some of the major competitors in this industry include:

- **McDonalds:** is the overall industry leader with 32,478 restaurants in 117 countries at year-end 2009 (IBISWorld, “US Fast Food Restaurants”).
- **Yum! Brands:** includes the brands KFC and Pizza Hut. Operates more than 33,000 stores in more than 100 countries in 2009 (IBISWorld, “US Fast Food Restaurants”).
- **Wendy’s Arby’s Group:** operated 10,259 stores globally in 2009 (IBISWorld, “US Fast Food Restaurants”).
- **Dunkin’ Donuts:** has 8,835 stores worldwide and operates in 31 countries (Dunkin’ Donuts, “About Us”).

## A.1 Porter’s 5 Forces

### *Threat of New Entrants: Medium-Low*

The threat of new entrants is medium to low in the specialty coffee industry. While opening a small independent coffee shop does not require significant inputs, larger coffee chains have successfully created some barriers to entry making it difficult for a new competitor to establish itself as a top brand. In fact, Starbucks is the only company who has been able to establish itself as a national chain (Hoovers). Barriers to entry for becoming a top player include the economies of scale realized by larger companies in the industry through their distribution systems. Meanwhile, quick service restaurant chains in particular, including McDonalds, that have branched into specialty coffees have positive spillovers from their already established marketing capabilities. In terms of supply costs, the giants also have advantages over new entrants as they are able to negotiate long-term contracts with coffee and dairy farmers to lock in at lower prices than the market rate.

In sum, there are not significant financial barriers to opening small coffee shops, which is why there are so many small independent or regional competitors today. However, the costs of expanding distribution networks and realizing the necessary economies of scale to become a national competitor, make it unlikely that a new entrant would pose a major threat or have a significant impact on the top competitors in the specialty coffee industry.

### *Bargaining Power of Suppliers: Medium-Low*



Coffee shops often purchase green (unroasted) coffee beans from brokers, farms, estates, exporters or cooperative groups (Hoovers). Most of the companies who compete in the premium coffee industry import high quality Arabica beans that trade for above the commodity prices (Hoovers). Farms that supply these beans are numerous and tend to be small. Individually, these types of suppliers are not able to exert much pressure on the market. Particularly in the early stages of the specialty coffee industry, coffee producers were highly dependent on big purchasers like Starbucks for their revenues. However, supplier power has increased somewhat over the past few years as the market for premium coffee beverages has grown rapidly; the increase in the number of smaller specialty coffee shops has caused the demand for high quality beans to rise accordingly. Large companies like Starbucks aim to limit supplier power and control quality and price variations by negotiating long-term contracts with suppliers. Likewise, large companies look to sign contracts with dairy suppliers (another major input for the industry) to limit price volatility (Hoovers).

In recent years, politically motivated initiatives like Fair Trade have attempted to limit the power of multinational corporations by giving suppliers in developing countries more power to charge a higher price for their product and work under fair conditions. The Fairtrade Labelling Organization (FLO) is an international body that certifies producers and manufacturers on their operations (Lloyd). Large specialty coffee companies like Starbucks and Caribou Coffee have tried to appeal to consumers' conscience by paying the higher price and offering certified Fair Trade products in their stores.

### *Bargaining Power of Buyers*

Buyers in the coffee shop are by and large individual consumers who do not buy in large volumes. Although these buyers, individually, do not have much power, the group of buyers as a whole does have some influence over the market. There are almost no switching costs, which make it easy for customers to change from one coffee shop to another. Also, customers are presented with many alternatives that include, to name a few: large specialty coffee shops, independent coffee shops, fast food chains that offer premium coffee beverages and convenience stores.

### *Threat of Substitute Products or Services: High*

The threat of substitute products or services is very high in the specialty coffee industry. Consumers are able to purchase coffee from lower cost coffee vendors, such as convenience stores. New initiatives from quick service restaurants advertise premium coffee beverages for a lower price. Alternatively, consumers can purchase either whole bean or ground coffee from the grocery store and brew their own coffee. There are also several alternatives to coffee in general including soft drinks and tea products. Soft drinks pose less of a threat in today's social environment, as consumers are becoming more health conscious and are avoiding carbonated products high in sugar like most sodas.

Another substitute on the rise as consumers become more concerned about their health, are tea products. Specialist tea shops are beginning to grow as consumers are becoming more educated about

the different types of tea and the health benefits of teas (Euromonitor, “Starbucks Corp in Consumer Foodservice”). Starbucks already carries a fairly wide selection of teas and is well positioned to move and capitalize on this trend as it progresses in coming years.

### *Rivalry among Existing Competitors: High*

Rivalry among existing competitors is high among the major competitors within the specialty coffee industry. The industry is concentrated as the top 50 companies generate more than 70 percent of sales (Hoovers). As the industry is becoming more concentrated and approaching the maturity stage of the life-cycle, companies are battling harder than ever for market share.

Competitors in the specialty coffee industry compete on various differentiation strategies to command high prices for their premium products. Starbucks creates what the company calls the “Starbucks Experience” that involves individualized customer attention and a comfortable neighborhood atmosphere. Caribou Coffee creates a somewhat different environment creating a more outdoorsy atmosphere with store layouts that replicate Alaskan ski lodges (Moon and Quelch).

Competition is mounting further as players from outside of the traditional specialty coffee niche, like quick-service restaurant giants McDonald’s and Dunkin’ Donuts, have increased their offerings of “premium” coffee and espresso beverages for a lower price. These quick-service food restaurants attract customers with the proposition of a one-stop location offering breakfast and premium coffee for a low price. Starbucks has attempted to respond to this increased competition by introducing its own breakfast value meal offerings.

**Appendix B** contains a more detailed analysis of financial results of competitors in this industry.

## A.3 Macroenvironment Analysis

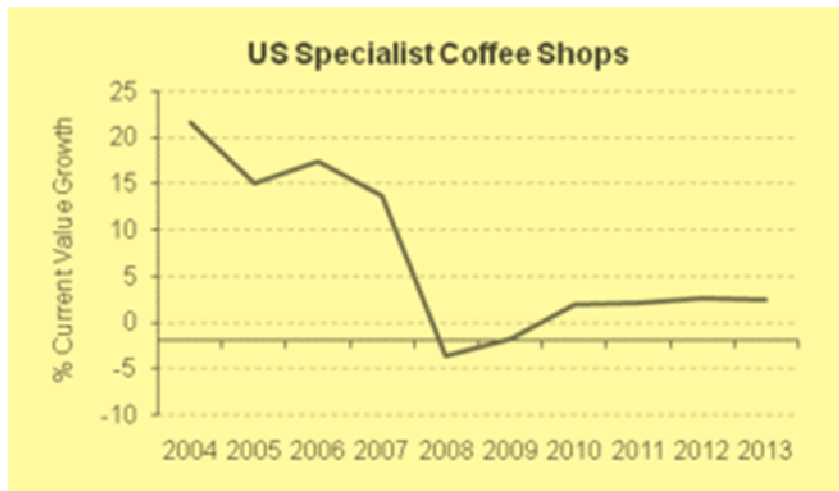
### *Political*

Political forces do play some role in this industry as green coffee beans must be imported from nations that have a tropical climate and altitudes suitable for growing coffee. If trade relations were to fall apart between the United States and a supplier country, there could be a significant impact on the coffee shop or specialty coffee industry.

### *Economic*

The economic downturn is having a large effect on the coffee shop industry. Specialty coffee in particular is largely considered a luxury good, which consumers tend to eliminate or trade down to lower cost alternatives as income decreases. Personal income is a demand driver in this industry (Hoovers). Figure 1 below shows the value growth as a percentage for specialty coffee industry in the US between 2004 and 2013.

Figure 1: US Specialist Coffee Shops % Value Growth



Source: Euromonitor, "Cafes/Bars USA"

The steep decline of the industry in 2008 is attributed to the collapse of the housing bubble and the economic crisis in the US.

Furthermore, commodity prices are expected to rise, which will undoubtedly have an impact on this industry. Fuel, coffee and milk prices all play an important role in this industry (Euromonitor, "Cafes/bars USA").

### **Social**

Social trends are also an important factor in the specialty coffee industry. Years ago consumers did not drink much coffee in the United States and the coffee culture that is present today was nonexistent (Moon and Quelch). Now coffee drinking is gaining popularity and coffee culture is expanding in the US and worldwide. Furthermore, the demographics of the average person who frequents the specialty coffee shop like Starbucks is expanding from the middle class worker to a larger base of customers in a lower income bracket (Moon and Quelch). These customers are also more price-sensitive and in times of economic hardship will either reduce or eliminate their trips to specialty coffee shops in an effort to cut down on expenses.

### **Technological**

Technology does play some role in this industry, however in the case of Starbucks the service is much more labor intensive and depends on the quality of the company's human resources. Technology in the espresso machines is important for companies in the specialty coffee industry. For example, in 2008 Starbucks upgraded all of its machines to Mastrena espresso machine designed especially for the company that "grinds every shot to order for superior consistency of espresso shots, greater options for milk steaming and customization, and a lower profile to enable baristas to connect visually with

customers for personal, immediate interaction and service” (“Starbucks Unveils New Strategic Initiatives”). In quick-service restaurants the entire process of serving coffee and espresso beverages tends to be automated and much more behind-the-scenes.

## A.4 Major Threats and Opportunities

### *Threats*

- ***Increasing Competition from Quick Service Chains:*** The threat posed by companies like McDonalds and Dunkin’ Donuts is becoming more serious as the economy is on the downturn and consumers are increasingly looking for cost-effective alternatives for their morning coffee.
- ***Economic Downturn in the US:*** The economic downturn in the US has already had a significant impact on the specialty coffee industry as consumers are cutting down on luxury expenses and trading down to lower-cost alternatives.

### *Opportunities*

- ***New Products and Expanded Menu Offerings:*** Starbucks has looked to counter the threat imposed by fast food chains like McDonalds on its core specialty coffee market by introducing new food offerings and a value meal to its menu. For \$3.95, customers can order a coffee and an egg sandwich, cup of oatmeal or coffee cake (Miller). The pricing strategy for this value meal aims to dispel the image of Starbucks as an unaffordable or overpriced brand and is a direct response to a campaign by McDonalds for its own espresso beverages that uses the slogan “Four bucks is dumb” (James). The new food products have the potential to attract new customers who are looking for a fancier, healthier and yet, still affordable, alternative to fast-food breakfast.
  - ***VIA Launch:*** Another product that Starbucks has introduced as an affordable option for customers is its new instant, soluble coffee product, VIA. The \$21 billion dollar instant coffee market is one that specialty coffee companies have tended to avoid as the perceived quality of instant coffee products is much lower (Baertlein). High quality VIA will occupy new market space as it is less expensive than handcrafted beverages offered by specialty coffee shops (VIA sells for \$2.95 for a 3-pack of single servings and \$9.95 for 12 packets) and more expensive than current instant coffee products from brands like Nestle and Taster’s Choice (about \$1.50 for 6 packets and \$4.00 for 20 packets) (Baertlein). VIA has the potential to be a disruptive innovation in the specialty coffee industry as its low-cost and high quality proposition stands to attract many new customers. Starbucks stands to reap the benefits of being a first-mover in this product category. Furthermore, VIA has even more opportunity in many markets overseas

where instant coffee still dominates (Baertlein). As of yet, Starbucks has not introduced VIA in supermarkets.

- ***Expanding Coffee Culture:*** Coffee culture is expanding and in many countries it is still untapped. The prospect for chained specialist coffee companies like Starbucks to extend their competencies to new markets abroad looks highly favorable. China appears to be a large opportunity as coffee culture is still relatively undeveloped and Starbucks has the opportunity to become a real first mover (Euromonitor, “Starbucks Corp in Consumer Foodservice”).
- ***Specialty Tea Shops:*** The rise of specialist tea shops in coming years could represent a good opportunity for Starbucks, who already carrying a large selection of teas stands in a favorable position to capitalize on this trend.

## Appendix B: Internal Analysis

### **Strengths**

**Leadership Position:** Starbucks is the undisputable leader in the specialty coffee industry. The brand name Starbucks has built is recognizable nationwide in the US and in many countries across the world as the company expands internationally. This brand recognition for consistency and high quality is very powerful for attracting and retaining customers.

**The Starbucks Experience:** Starbucks has found a way to differentiate itself by creating a unique value proposition for customers as a “third space between home and work/school” (Moon and Quelch). All of the locations have a similar layout with desks and plush chairs to sit and work or just relax. Locations also offer Wi-Fi hotspots so customers can enjoy a beverage while they work. Starbucks CEO, Howard Shultz defines the three components to the Starbucks “experience” as:

- High quality coffee: Sourced from around the world and custom-roasted.
- Service: “Customer intimacy”, recognizing regulars, customizing drinks to the customer’s tastes.
- Atmosphere: Community environment, lounge chairs and a fire place that creates a place where customers feel welcome to linger (Moon and Quelch).

**Alliances with Foodservice Companies:** Starbucks has formed alliances with established companies in the foodservice industry, like Kraft, Unilever, and PepsiCo that share the company’s commitment to quality to reach new markets (Euromonitor, “Starbucks Corp in Consumer Foodservice”). While these products do not represent a significant portion of Starbucks’ revenue, they are an integral part of building brand loyalty and reaching new customers.

**My Starbucks Rewards Program:** On January 5, 2010 Starbucks launched a new customer loyalty program entitled “My Starbucks Rewards” to consolidate its Starbucks Card and Starbucks Rewards Gold Card. The Starbucks Rewards Gold Card required customers to pay a \$25 annual fee for the right to 10% discounts on drinks, while the Starbucks Card was simple a registered reloadable gift card. The new program is free and will absorb members from both programs. Members of the My Starbucks Rewards program will be rewarded based on the number of purchases they make. After 5 purchases customers will be upgraded to the Green Level where benefits include free syrups, soymilk, free brewed coffee refills and two free hours of Wi-Fi access; after 30 purchases customers reach the Gold Level where benefits include a free beverage after every 15 purchases and personalized coupons (Starbucks, “My Starbucks Rewards”).

Starbucks estimates that there are 5 million active Starbucks Card holders at any given time and about 1-in-7 transactions in the US involve one of these cards (“Starbucks to Add to Popular Prepaid Card Program”).

## **Weaknesses**

**Market Saturation Strategy:** Starbucks' strategy for expanding its retail business was to open stores in new markets while geographically clustering stores in existing markets (Moon and Quelch). The cannibalization that resulted from this strategy was not a major problem when the economy was favorable and consumer spending was on the rise; however, the effects of this strategy are now having severe consequences for the company as consumers are cutting down on spending. In the second quarter of 2009 Starbucks saw its net income fall by 77% (Flynn). This decrease also takes into account the more than 500 store closings that have occurred since 2008 as the company looks to restructure its costs (Flynn).

**Effect of Growth on Brand Image:** Starbucks incredible growth has had some negative effects on the company's image as customers to perceive that revenue and profit may be top interests for Starbucks and not “people first” as the company's value statement alleges. The community environment that Starbucks worked so hard to create is fading for a colder more corporate profit-hungry interests.

**Dependence on the US market:** Starbucks has nearly 70% of its outlets in the US, where the current economic downturn is having serious negative effects on the specialty coffee industry as a whole.

## **B.2 Resources and Competitive Advantage**

**Partners:** Starbucks' partners (the term the company uses for its employees) are one of its most important resources. Employees must be trained to make all of Starbucks' specialty beverages and make changes based on what the customer wants. Since Starbucks looks to create an experience, having friendly, knowledgeable baristas is an important part of maintaining the company's image.

**Supply Chain:** To enforce its exacting coffee standards, Starbucks controlled as much of the supply chain as possible—it worked directly with growers in various countries of origin to purchase green coffee beans, it oversaw the custom-roasting process for the company's various blends and single-origin coffees, and it controlled distribution to retail stores around the world. (Moon and Quelch). Partnerships with suppliers ensure quality and that everyone in the value chain shares common goals.

**Distribution network:** Starbucks engages in a wide range of distribution including through its company-owned stores, franchises, and licensed products pushed through the grocery outlet. Starbucks often engages with third parties share who share the company's values and commitment to quality. Starbucks uses these third party relationships to attract newcomers. While licensed products do not represent a large portion of the company's revenues (4% in 2008), these items are an integral part of familiarizing customers with the Starbucks name and developing brand loyalty (Euromonitor, “Starbucks Corp in

Consumer Foodservice”). In fact, about 40% of new customers at Starbucks’ stores have already tried the Starbucks brand before they visit a coffeehouse (Moon and Quelch).

### **B.3 Financial Health**

Once a seemingly unstoppable beacon of growth, Starbucks has shown its first signs of weakness as the economic crisis in the US has worsened. Figure 2 below shows the company’s revenue mapped against its profit from 2002 to 2008:

**Figure 2: Starbucks’ Revenue vs Profit (2002-2008)**



2

Source: Euromonitor, “Starbucks Corp in Consumer Foodservice”

The company’s revenue has continued to increase, albeit more slowly than in past years; however, 2008 saw a major decrease in profit as Starbucks closed more than 500 stores (Flynn).

One popular indicator companies in the Foodservice industry use to measure performance is same or comparable store sales growth. This figure represents the revenue earned by a company’s stores that have been open for a year or more. Table 1 below summarizes same stores sales growth figures for Starbucks and two of its competitors, Caribou Coffee and McDonalds.

**Table 1: Change in Same Store Sales in the US (2005-2009)**

Year	Starbucks	Caribou Coffee	McDonalds
2005	9%	6%	7%
2006	7%	-1%	N/A
2007	4%	0%	4.5%
2008	-5%	-4%	4.0%
2009	-6%	-2%	2.6%

Source: “Investor Relations” Annual Reports of Starbucks, Caribou Coffee, McDonalds



The same store sales growth figures show that the specialty coffee industry was adversely effected by the US economic crisis in 2008 and 2009 as both Starbucks and Caribou Coffee experienced negative growth. The table also shows that Starbucks was impacted on a much larger scale than its competitor, Caribou Coffee. This large decrease is most likely a result of Starbucks expansion strategy that involved building a high concentration of stores in the areas where it operates. Because of this saturation strategy, even a small decrease in consumer spending has had a large impact on same store sales. Conversely, McDonalds has seen same stores sales rise throughout the economic crisis as consumers looking to save money trade down to less costly alternatives such as fast food products.

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