

CASE STUDY

Starbucks Corporation

Present

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By

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Outline

Topic	Page
1. Industry overview	1
2. 5 Forces Model	2
3. Driving Forces	4
4. Strategic Group Map	4
5. Industry Attractiveness	5
6. Key Success Factors	5
7. SWOT Analysis	5
8. Financial Analysis	7
9. Strategy implementation	9

1. Industry overview

Coffee specialty industry is in the growing business life cycle as there are a lot of stores opening rapidly in the US within the decade. In 1997, there were 8,000 stores in the US region, an 1,500% increase from 500 stores in 1992. Sales growth in an industry is challenging and coffee consumption of people in the US is growing.

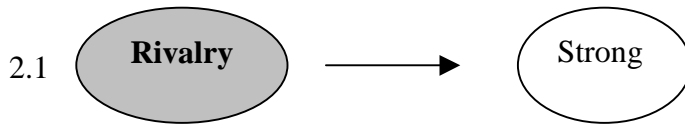
Population growth in the US creates change in beverage consumption and spending. There were 266 million people in USA in 1997 and it is predicted to increase to 392 million by 2050, a 50% increase over the 1990 population¹. The Census Bureau estimates that total population is likely to increase about 0.9 % annually during the remainder of the 1990's.

Societal and lifestyle change of people is complement with the demand for specialty coffee stores. General changes in family life—women working in full and part time positions has resulted in more 'eating out'². Coffee stores are also be set as a place for community meeting, second relaxing home, and place to spend leisure time.

¹ Food & Beverage Industry Distribution Channels Study, Agriculture and Agri-food Canada

² <http://www.students.bucknell.edu>

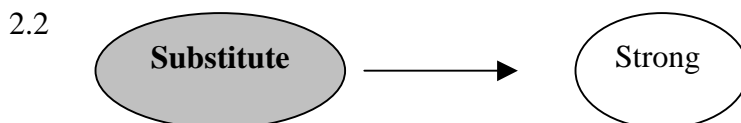
2.5 Forces Model



- The number of coffee cafes in the US growth rapidly from 500 in 1992 to 8,000 specialty coffee outlets in 1997 and estimated 10,000 by 1999.
- Rivalry is usually stronger when demand for product is growing slowly. Customers switch to competitors easily because of available number of coffee stores. Starbucks did not offer lattes with nonfat milk so customers left to nearby competitor stores at once.
- Customer costs to switch brand are low.
- Figure 1 shows growth rate of sales and EPS of Starbucks and also sales growth of major competitor, New World Coffee. Both show an increasing trend of industry attractiveness for rivals.

Figure 1: Growth rate percentage ³

Growth Rate	1YR	3YR	5YR
Starbucks			
Sales (%)	34.17	41.17	49.28
EPS (%)	21.57	26.91	41.32
New World Coffee			
Sales (%)	8.91	21.77	39.91

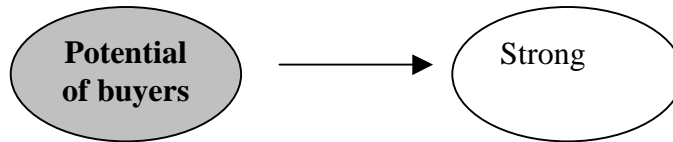


- Substitutes for specialty coffee industry are coffee products produced by nationwide manufacturers such as Kraft General Foods, P&G, and Nestle. These products are available in supermarkets and other convenience stores.
- In terms of product itself, coffee can be replaced by other beverage supply throughout the country. Such these beverages are Juices, Alcoholic beverages and soft drinks.

³ Stocks analysis from Marketguide (<http://finance.yahoo.com>)

- Restaurants that offer specialty coffees and install machines to serve coffee products such as espresso, cappuccino, latte and others are also substitutes for specialty coffee outlets.
- Quality and price of substitutes are comparable for consumers also. They can switch easily.

2.3



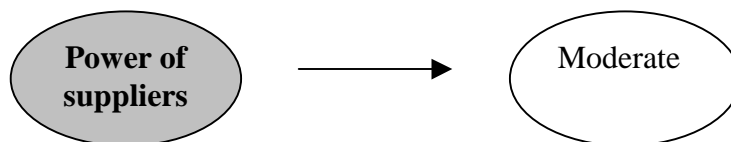
- There are large number of buyers who are well informed about products, prices and costs. In case of Starbucks, its employees had a role to explain knowledge of coffee taste and other relevant information to customers.
- Cost switch to competitive brands are low

2.4



- Low entry barriers:
 - Technology + specialized know how requirement related to the industry are low. Coffee produced equipment and other related equipment developments are not changing drastically.
 - No patent for raw materials, dark roast so it is impossible to bar the entry of imitative competitors.
 - Low brand preference and customer loyalty

2.5



- Items supplied (bean, roasted coffee) are standard commodities available on the open market
- High availability of coffee, coffee is the world's second largest traded commodity
- There are large number of suppliers, switching purchase among them is easy

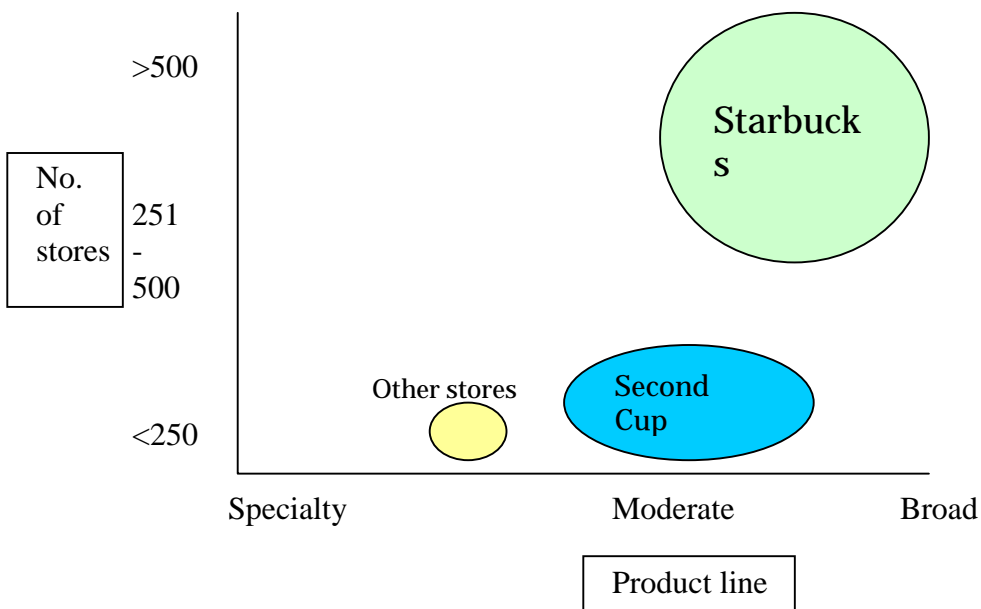
But

- Suppliers can supply goods lower than industry member can make it themselves
- Well-being of suppliers do not lie with buyers of this industry alone → suppliers can supply to other industry such as candy, ice-cream
- Coffee prices are subjected to volatility due to weather, economic and political conditions as well as agreements establishing export quotas and restrictions from the International Coffee Organization

3. Driving Forces

- 3.1 **Emerging buyer preferences for differentiate products instead of a commodity product.** Sellers can offer more loyal buyer by introducing new features, creating image differences with package and test.
- 3.2 **Changing societal concerns, attitudes and lifestyle.** Drink coffee and meet friends, coffee stores are like community gathering place. Also, drinking coffee outside home is becoming lifestyle of American people during rush hour.
- 3.3 **Relationship with suppliers.** Buyers commit number of purchasing with suppliers and apply JIT basis delivery. Long-term commitment helps buyers a lot for availability of supply over time
- 3.4 **Increasing globalization of the industry.** Natural resources are available in all area in the world for example Brazil and Asian countries. Demand for industry's product also pop up in more countries such as Asia Pacific area.
- 3.5 **Entry or exit of major firms.** New entrants put competition in new directions
- 3.6 *Consumer potential changes rapidly.* Sellers have to build customer loyalty to maintain them
- 3.7 **Marketing innovation.** Internet is becoming vehicle for marketing innovations and the trend that firms will use is increased.

4. Strategic Group Map



From Strategic Group Map, Starbucks stands at the high end in the position. Its stores locations are estimated to 2,000 stores all around the world. Second cup is about one-third in size of Starbucks, has not reached 250 stores all around the world. The other small coffee specialty stores that are notably New World Coffee, Coffee People, Coffee

Station, Java Centrale, and Caribou Coffee expected to merge regional chains in effort to get bigger and better position themselves as an alternative to Starbucks.

5. Industry Attractiveness

Is Coffee specialty industry attractive? Yes, but it is for the firm who can distinguish itself from others and it should have long term strategic vision to gain competitive advantage from competitors over time.

6. Key Success Factors

6.1 Skill-related KSFs

- Superior workforce talent (*barista*, high professional services skills in terms of product knowledge)
- An ability to develop innovative products and product improvements (like Starbucks introduced Power Frappuccino in 1997 and Chai Tea Latte in 1998)

6.2 Organizational Capacity

- Superior ability to employ the Internet or Electronic commerce to conduct business (Starbucks offers E-commerce for purchasing products online)
- Managerial know-how

6.3 Marketing-Related KSFs

- Courteous customer service.
- Breadth of product line and product selection

6.4 Other types of KSFs

- Convenient locations (Starbucks had totally 1,364 stores in continental North America area in 1997 as compared to 165 stores in 1992)
- Pleasant, courteous employees in all customer contact positions

7. SWOT Analysis

Strength and competitive capabilities

- Valuable human resources: **Howard Schultz**
His superb idea: Starbucks should offer drinking beverages, open stores outside Seattle and go abroad (Canada).
He also worked with store employees to develop custom-friendly sales skills and produce brochures for customers
- **Olsen**
His superb idea: Forming and communicating a vision, raising money, finding good store locations, building a brand name and planning for growth
- Product innovation skill. Starbucks introduced the new cold coffee drink, called Frappuccino in 1995, and it had proven to be a hot-weather seller
- A reputation for good customer service: Starbucks has commitment to quality and customer satisfaction
- Acquisition with Starbucks in August 1987 and built a new name “Starbucks Corporation”

Strength and competitive capabilities (continued)

- *Starbucks was listed in the Hoover's Handbook 1996 as one of the up and comers in the industry*
- *Business Enterprise Trust Award for innovative benefits plan – Dec 6, 1994*
- *Named one of America's 100 fastest growing companies—Fortune magazine Aug 8, 94*
- Joint venture with PepsiCo to create new coffee-related products for mass distribution through Pepsi channels, including cold coffee drinks in a bottle or can.
- Strong financial condition: Revenues, profits, return on total assets increased over time from 1993 to 1998. Leverage ratio decreased. EPS increased from 0.14 in 1993 to 0.86 per share in 1998.
- Starbucks avoided debt and financed new stores entirely with equity capital. It improved company profitability and strengthened balance sheet
- Low employee turnover rate (for baristas ran about 65% out of 400% in average and managers 25% out of 50% average)

Weaknesses and competitive deficiencies

- Falling behind in R&D. Starbucks did not emphasize on R&D program for product innovation.
- Short on financial resources. Starbucks fell behind profit from 1984-1990 because of debt financing according to Schultz's idea for entering beverage part of coffee business or expand number of Starbucks stores.

Potential Company Opportunities

- Serving additional customer groups. Starbucks expanded into new geographic markets or product segments outside Pacific Northwest (see figure 2). Also, Starbucks had licensing agreement in areas where it didn't have ability to locate its own outlets.

Figure 2: Starbucks branches and growth in expansion (1992-1997)

No. of stores open	97	growth	96	growth	95	growth	94	growth	93	growth	92
Continental North America											
Company-operated stores	1270	37%	929	48%	627	57%	399	53%	260	60%	162
Licensed stores	94	25%	75	53%	49	88%	26	117%	12	300%	3
Outside North America											
Licensed stores	17	750%	2	200%	-	-	-	-	-	-	-
Total	1381	37%	1006	49%	676	59%	425	56%	272	65%	165

- International expansion. Starbucks created a new subsidiary called SCI, to orchestrate overseas expansion and begin to build Starbucks brand name globally via licensees

Potential Company Opportunities (continued)

- Starbucks went public in June 1992. It could capture more funding from investors and this incident helped Starbucks profit increased. Since it went public, Starbucks stock price increased greatly, from 3.7812 in September 1992 to 15.7812 in September 1998
- Starbucks had specialty sales group that provided its coffee products to restaurants, airlines, hotels, universities, hospitals, business offices, country clubs and select retailers.
- Partnership with Dreyer's Grand Ice Cream to supply coffee extract for a new line of coffee ice cream. Also, in 1995, Starbucks worked with Seattle's Redhook Ale Brewery to create Double Black Stout, a stout beer with a shot of Starbucks coffee extract.

Potential external Threats to a company's Well-Being

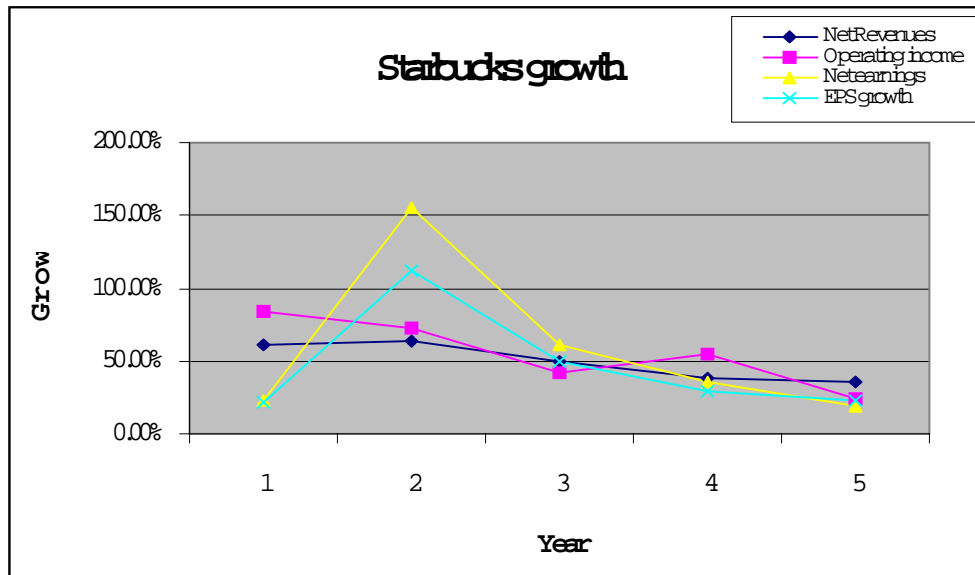
- Likely to entry of potent new competitors. Growth rate of Starbucks increased rapidly from one year to five year so it attracts competitors to join in the industry.

8. Financial Analysis

8.1 Operating Growth

Figure 3 shows growth rate of Starbucks operation. Notice that Starbucks growth in a decreasing rate from 1994 – 1998. This was due to Starbucks expansion rapidly throughout the country. Revenue increase compensated with investment settled at the beginning periods so profitability ratio showed in a decreasing way.

Figure 3: Starbucks growth comparison (1994-1998)



8.2 Ratio comparisons

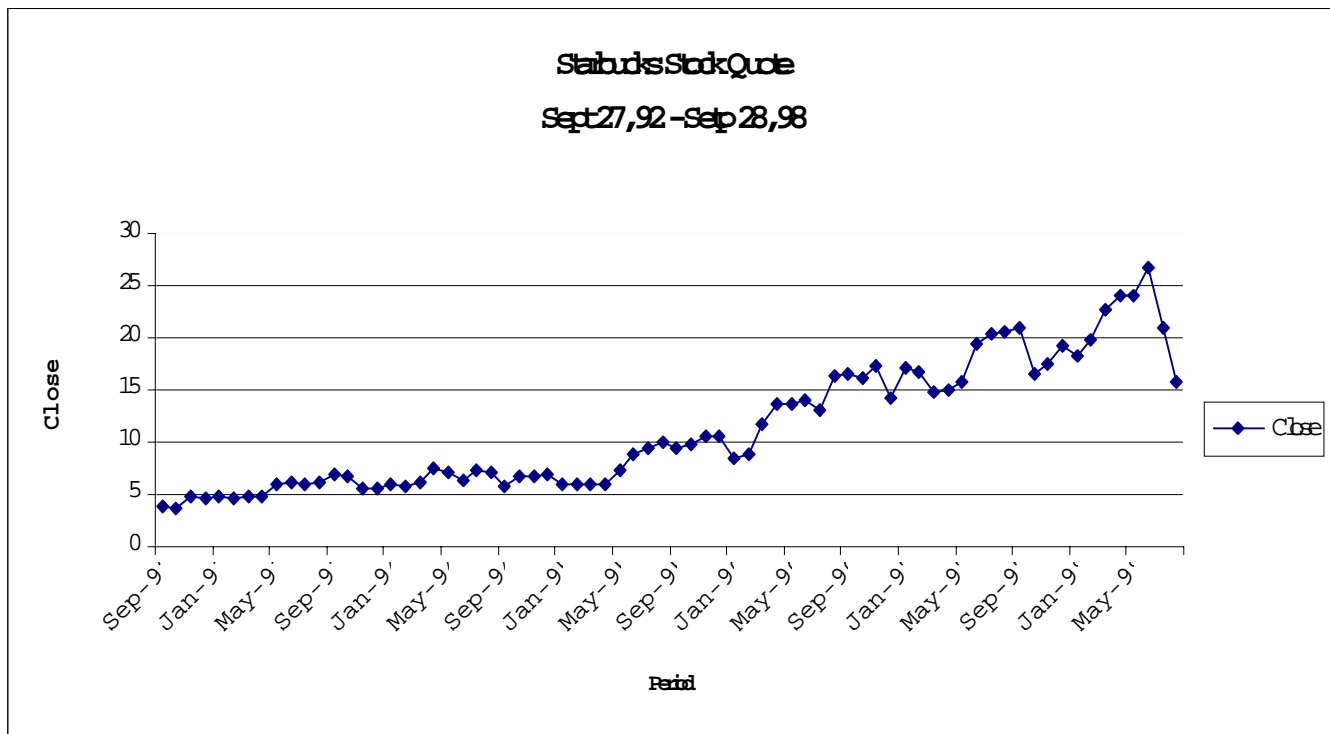
According to Figure 4: Ratio comparisons of Starbucks from year 1993 – 1998 next page, Starbucks profitability ratio was increased slightly from time to time. Leverage ratio also improved better. Capital structure of Starbucks was strong. Look at debt-to-equity ratio, the company reduced debt from 61% of total capital in 1996 to 25% in 1998. It also showed high financial position of Starbucks overtime too. Also, Activity ratio was better as fixed assets turnover ratio improved. However, the company had problems with liquidity as liquidity ratio decreased annually from 1999 to 1998. This was because the company had an increasing amount of short-term debts, from 101.1 \$Mil in 1996 to 179.5 \$Mil in 1998, a 77.6% increase.

Figure 4: Ratio comparison						
Ratio Comparison						
Starbucks						
	98	97	96	95	94	93
Profitability ratio						
Operating profit margin	8.345%	9.124%	8.183%	8.623%	8.177%	7.147%
Net profit margin	5.224%	5.937%	6.049%	5.611%	3.582%	5.200%
Return on Total assets	6.887%	6.749%	5.798%	5.575%	4.410%	4.106%
Return on Stockholder's Equity	8.61%	10.80%	9.33%	8.36%	9.29%	9.34%
EPS	0.86	0.73	0.54	0.36	0.17	0.14
Liquidity ratio						
Current ratio	1.879	2.277	3.359	N.A.	N.A.	N.A.
Quick ratio	N.A.	1.418	2.534	N.A.	N.A.	N.A.
Inventory to Net Working Capital	N.A.	0.673	0.350	N.A.	N.A.	N.A.
Leverage ratio						
Debt-to-assets ratio	0.200	0.380	0.378	N.A.	N.A.	N.A.
Debt-to-equity ratio	0.250	0.608	0.609	N.A.	N.A.	N.A.
Long-term-debt-to-equity ratio	N.A.	0.338	0.385	N.A.	N.A.	N.A.
Interest coverage ratio	84.1	13.800	8.900	12.300	5.700	20.900
Activity ratio						
Inventory turnover	N.A.	8.090	8.354	N.A.	N.A.	N.A.
Fixed assets turnover	2.178	2.001	1.885	N.A.	N.A.	N.A.
A/R turnover	25.675	31.678	39.526	N.A.	N.A.	N.A.
Average collection period	14.216	11.522	9.235	N.A.	N.A.	N.A.
Other ratio						
P/E ratio	47.6	63.4	61.1	52.6	64.1	85.5
Price/Sales	2.48	3.42	3.67	2.89	2.35	4.56

8.3 Shareholder values

Shareholders of Starbucks enjoyed its high stock price. Because Starbucks had very good operating results, as shown in a percentage increase in operating results and good financial ratios, Starbucks stock prices had increased eventually over the period of 1992 – 1998. As stated in figure 5, market stock price for September 1992 was \$3.7812 and for August 1998 was \$15.7812, a 317% increase. Also, EPS increased over time from \$0.17 in 1994 to \$0.86 in 1998, which was 405.88% increase.

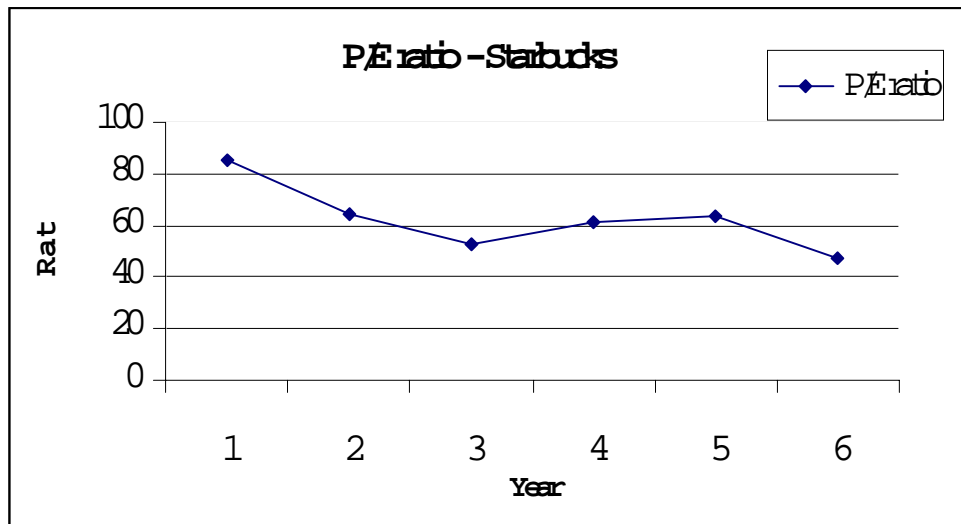
Figure 5: Starbucks stock quotes



Shareholders could be assured for safety of the company. In figure 6, P/E ratio for Starbucks tended to decrease. P/E ratio valued 85.5 in 1993 to 47.6 in 1998. P/E ratio means the degree of risk of the business in which faster growing or less risky firms tend to have higher P/E ratio than slower growing or more risky firms. Starbucks became less risky due to one of major reasons that was the employee stock option plan called “ Bean Stock program”. Employees felt shared value in an organization and they were motivated. At the end of fiscal year 1997, there were 8.7 million shares in outstanding options at average exercise price of \$19.72 (from current stock price \$43.5). This pursued total number of stocks issued of 150,000,000 shares with 79,058,754 shares outstanding.

Figure 6: Starbucks P/E ratio (1993-1998)⁴

⁴ Wall Street Research Net (<http://www.wsrn.com/home/dataset/quicksources.html>)



9. Strategy implementation

9.1 Broad Differentiation Strategy

Starbucks need to gain buyer loyalty to its brand. The company is in a growing industry so it can differentiate its products from other competitors to bond customers with the company.

Along value chain, it can create the differentiating attributes through *purchasing and procurement activities*. Starbucks has strategy to commit itself to quality so it needs to select the best providers and make long relationship with suppliers. Also, it can reduce cost of supplies by adopting JIT basis. Inventory cost and space costs can be reduced and defect rates will be lower, as suppliers are highly reliable. *Marketing, sales, and customer service activities* are also important as it can result in superior and better product information, more frequent sales calls and faster order processing.

Benefits of differentiation strategy are to erect entry barriers in the form of customer loyalty and, lessens buyers' bargaining power since products of others are less attractive and helps a firm to fend off substitutes that do not have comparable features or attributes.

9.2 Using Value Chain to build core competencies and competitive capabilities

By looking at value chain, the company should pinpoint the primary value chain activities and competencies that are important in successfully executing the strategy.

Primary activity and costs: Operation. It is accounted for 45.4%, 48.2% and 44.7% of sales in 1995 – 1997 respectively (Income statement common size analysis). It was the highest proportion of costs as compared to sales volumes.

Support activity and costs: Human resources. Starbucks emphasis on skilled employees and support their expertise by using training program to both baristas and store managers.

9.3 Empowerment

Starbucks should lodge decision-making authority to persons or teams closest to and most knowledgeable about the situation. Each of them can have responsibility of their own and performance trace back can be done easily. Employees can feel they belong to an organization and feel they are important. Nowadays, the new preference for leaner management structures and empowered employees is grounded for three reasons.

First, transformation from Industrial age to Information system age, hierarchical structure should go flatter to emphasis on building competitively valuable cross-functional capabilities. Second, decision-making authority to lower level employees can help organization with timely, informed and competent decisions. Third, employees can exercise judgements that are pertaining to their jobs.

9.4 Strategy supportive motivational practices

- Health care benefits (to honor employees value and contribution)
- Stock option plans. “Bean Stock” program was a stock option for all employees. The purpose was to turn all employees into partners, giving them success to share the success of the company

9.5 Installing support systems (Database system)

Support systems can help organization manage resources quickly, as information will be kept in computerized term in systematic manner and users can retrieve information, view, and update information right away. Moreover, data can be shared throughout store branches.

9.6 Build a strong company culture

Development of strong culture consists of a strong leader who can establish values, principles and practices. Company commitment to operating business across the established tradition is also important. Further, well-being concern of three entities, customers, employees and shareholders is needed.

9.7 Building ethical standards and values into the culture

Starbucks had *mission statement* and employees could use comment card to review the other people who do not follow mission.

9.8 Exerting strategic leadership

The leader should keep the organization responsive to changing conditions; for example, alert for new opportunities and come up with innovative ideas. Furthermore, leader should stay on top of what is happening and see how well things are going. Next, push corrective actions to improve strategy execution and overall organization performance.