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Strategic Audit: Starbucks

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Abstract

Starbucks Corporation is an international coffee brand that is expanding operations. There are many obstacles to this level of growth, and the company needs to take great care in the differentiating the way stores are built in the United States and internationally. In order to establish brand longevity, the company should examine several strategic options. A final strategy can be chosen based on the results of a situational analysis, financial analysis, and company goals. After a final strategic recommendation has been made, a contingency plan will be created to ensure long-term success.

Key Words: management, strategy, Starbucks

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Brief History of Starbucks

Starbucks was founded by Gordon Bowker, Jerry Baldwin, and Zev Siegl. They were inexperienced businessmen, and after previous meetings at earlier points in their lives, they met again in Seattle and decided to start a coffee company (Farrr, 2019). Starbucks opened its first store in Seattle, Washington in 1971 (Starbucks Corporation, 2019). Unlike the stores that exist now, it did not sell drinks. Instead, it sold coffee beans, teas, and brewing equipment such as grinders and teapots (Farr, 2017). Despite low net income in the first year, Bowker, Baldwin, and Siegl decided to open another store in the second year of business (Farr, 2017).

Shortly after the opening of the second store, the owners took on the responsibility of roasting their own beans, and they rented another building to act as their roasting plant. Starbucks continued growing, but it faced challenges from increases in the price of coffee beans due to harvest issues in Brazil (Farr, 2017). It recovered from these struggles and the loss of an original business partner to open its first coffee bar in 1984. (Farr, 2017). It moved the director of retail operations and marketing, Howard Schultz to create a new company, Il Giornale, that focused entirely on selling coffee beverages brewed from Starbucks beans (Starbucks Corporation, 2019). In 1987, Il Giornale bought Starbucks and changed its name to Starbucks Corporation (Starbucks Corporation, 2019).

Over thirty years later, Starbucks continues its commitment to "inspire and nurture the human spirit, one person, one cup, and one neighborhood at a time." Having grown exponentially since its inception, Starbucks now operates over 30,000 stores in 78 markets and earns over $24 billion in revenue (Starbucks Corporation, 2019). Starbucks focuses on providing the best coffee possible in the most ethical way, from coffee bean growth, to store service and corporate practices.

Situation Analysis

Starbucks is currently focused on increasing growth and maintaining its reputation for ethical practices and quality coffee. To determine the feasibility of these goals and the best strategy for Starbucks as it moves forward, an analysis of the situation is necessary.

External Environment: To evaluate the best strategy for Starbucks Corporation and understand if their current goals are conducive to generating profit and overall success, an analysis of the industry, economic climate, and market must be conducted.

PEST Analysis

The general environment and market conditions can be broken down by political, economic, social, and technological components.

Political and Legal Environment: As an international company, Starbucks is subject to the laws and regulations of every country in which it conducts business. More specifically, it must consider the stability of governments, taxes, and labor practices. The majority of Starbucks' 29,000 locations are located in the United States, which has a stable government and labor practices. However, there are often changes in taxation, such as the Tax Cuts and Jobs Act of 2017 which lowered corporate tax rates from 35 percent to 21 percent (Horowitz, 2017).

When considering the goal of increased international growth, political stability is critical. Starbucks has stores in 78 markets, including Egypt, Lebanon, and Mexico (Starbucks Corporation, 2019). All of these countries have ongoing political problems, such as recovery from civil war and high levels of criminal violence resulting from drug trafficking (Council on Foreign Relations, 2019). This could impact whether Starbucks can continue to operate in these countries.

<u>Economic Environment</u>: Starbucks provides products that are nonessential. Consequently, the economic environment is particularly relevant to the company. Since the bulk of Starbucks stores are located in the United States, the economic climate in the US is a critical driver of revenues. The economy is stable and expected to continue with GDP slowing slightly from 2018 to 2021 but staying close to the ideal range of 2-3 percent. Additionally, the unemployment rate is expected to remian around 3.9 percent, well below the Federal Reserve's target unemployment rate (Amadeo, 2019). These factors indicate that the United States will continue to be a stable revenue source for Starbucks.

<u>Social-Demographic Environment</u>: There is an increasing demand for ethically sourced products, as well as an emphasis on corporate responsibility. Consumers do not want to support companies that are discriminatory, destroy local culture, or mistreat employees. Environmental impact is another issue that is important to modern consumers, and companies that are environmentally irresponsible or have a large carbon footprint have faced backlash. Another factor that is important to millennial consumers, a group that heavily frequents Starbucks, is customization. Customers want to be able to modify products to fit their individual needs.

<u>Technological Environment</u>: In the digital age, technology is vital to a company's success. Incorporation of mobile ordering, mobile apps, and in-store ordering kiosks are all at the forefront of tech in the food industry. There is a rising trend towards streamlining customer experiences, and companies like McDonald's have introduced ordering kiosks instead of having traditional cashiers. In the coffee industry, technology is increasingly important for speed and customization.

Porter's Five Forces

<u>Threat of New Entrants</u>: Moderate

Starbucks faces competition from national chains as well as local coffee shops. The industry is relatively easy to join, as renting a storefront and equipment is not exorbitantly expensive, but there is a challenge in overcoming the resources of established coffee houses such as Starbucks. The threat of new national entrants is small, as there are not as many chains focused specifically on coffee or making a move to do so. Together, these conditions make the threat of new entrants a moderate concern.

Threat of Substitution: High
Starbucks offers quality coffees and teas, but there are several alternatives in existence. There are competing national chains like Dunkin Donuts and McDonalds that have expanded into providing affordable coffee drinks to customers (White, 2016). Additionally, there are several at-home alternatives like Nespresso and Keurig that create cost-effectively create high-quality beverages. Starbucks has attempted to offset this by selling bottled versions of drinks, boxes of Teavana teas, and bags of its coffee beans, as well as equipment for brewing drinks, such as the Verismo Brewer and Milk Frother (Starbucks, 2019). However, these products can still be substituted by other brands.

Power of Suppliers: Low
Due to its size, Starbucks works with roughly 300,000 coffee bean growers worldwide (Sargent, 2018). This large network is due in part to its commitment to using only Fair Trade and sustainably grown product. However, the variety of suppliers keeps bargaining power low, as Starbucks can shift their supply orders to other growers if one begins to price their product higher than Starbucks is willing to pay.

Power of Buyers: High
Starbucks markets itself as an affordable luxury, but it is still a luxury. Consumers are not obligated to spend their money on coffee, which gives them the power to stop purchasing Starbucks' products. Furthermore, there is no cost to consumers for switching to an alternative, which gives them a high bargaining power. Without customers, Starbucks would not be able to exist.

Threat of Competitive Rivalry: Moderate-High
Combining the effects of other four forces, the threat of competitive rivalry is a moderate to high concern. The threat of substitution is a particular concern, as it comes not only from other coffee chains, but also at-home products. The high bargaining power of buyers and moderate threat of new entrants also keep the environment competitive as there are many opportunities for customers to stop using Starbucks, as well as for smaller coffee shops to eat away at Starbucks' large market share.

Life-Cycle Position
As seen in Figure 1, four stages describe the life cycle of a business. Starbucks falls into the maturity stage. It is able to defend its position as the leader in market share for the coffee industry. Starbucks is also able to enter new markets due to brand name recognition with consumers (Dempsey, 2018). In order to prevent the company from entering the decline stage, it should look at growth opportunities and other ways to reinvest in itself.

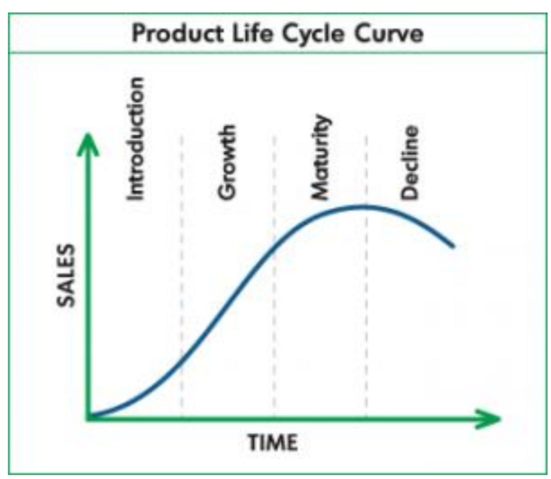

Figure 1: Business / Product Life-Cycle
Source: (Flekel, 2013)

A comprehensive look at the external environment places Starbucks in a relatively stable environment with the name recognition and revenues to continue operations and possibly consider expanding.

Internal Environment: The internal environment at Starbucks is important when considering the longevity of the company and areas for improvement or expansion.

SWOT Analysis

Strengths: Starbucks is currently dominating the coffee business, and it has many strengths. One of the main advantages of Starbucks is its name recognition. Due to its significant presence, 30,000 locations, Starbucks is recognized around the globe as a leader in the coffee and café industry (Starbucks Corporation, 2019). It made this happen through another strength, establishing a loyal customer base. This is due largely in part to its ability to incorporate technology by creating a loyalty program that rewards frequent users with free drinks (Starbucks Corporation, 2019).

Starbucks has also marketed itself as a responsible company. It has developed a firm policy of social responsibility and committed itself to sustainability and using only goods that are ethically sourced. It has also developed programs that benefit the communities it exists in as well as its store employees, such as providing college funding for workers. By offering benefits and showing that it is not another soulless corporation, customers are more willing to support the company by making purchases.

Weaknesses: Starbucks has locations around the world, but many of them are located in the United States (Jargon, 2018). With over 14,000 locations, the company may have oversaturated the market, and its performance is now heavily rooted in the performance of its US stores. A similar issue is that approximately half of Starbucks stores are company-owned, while the other half are licensed stores (Starbucks Corporation, 2019). This is a weakness as it takes more capital to open a corporate store than a licensed one, which limits growth opportunities.

Other weaknesses include the integration of local cultures into menus and store design, particularly in international locations. Not every culture enjoys coffee served the way United States consumers do, and the company needs to tailor its menu to store locations more. Another weakness is that Starbucks has high prices. Prices pose a serious issue when considering expansion; locations would likely need to be aimed at developed countries as the level of longevity would be uncertain with a developing country.

Opportunities: Starbucks has the opportunity to expand. The company can expand further into other countries and diversify its store locations, which could minimize the risk of economic changes in the United States impacting the business negatively.

The company also has a coffee at-home line that could be improved, and additional products could be added to it. There is an opening for Starbucks to ally with retailers to push more of its products through, which would increase revenue and help fund other updates or global expansion.

Threats: The competitive environment described in Porter's Five Forces analysis shows that Starbucks could be vulnerable to lower-priced competitors. The quality of coffee and tea at competitors like Dunkin Donuts is lower, but the prices are much lower. If consumer tastes change, then Starbucks could lose customers.

Price and availability of inputs is a substantial threat to the corporation. The cost of coffee beans can fluctuate, which has caused problems with profitability at several times in the company's history. Starbucks cannot operate without its supply of coffee beans, so it is forced to pay whatever price is necessary for its inputs.

Competitive Advantage

Starbucks' competitive advantage arises from its ability to innovate offerings and experiences. Starbucks' core competencies revolve around its products and the experience created in its stores. Part of its mission statement is to nurture the human spirit one cup at a time, and it prides itself on creating products that are different from its competitors. It is continually adding new drinks to the menu, and it rotates in seasonal drinks to draw in new customers and increase visits from existing customers. Starbucks has also focused on establishing itself as a "third place" to spend time, outside of home and work. The company is also recognizing the different needs of its customers by creating drive-through only and express stores (Trefis Team, 2016). Starbucks has differentiated itself through innovation.

Leadership: The current CEO of Starbucks is Kevin Johnson. He assumed the role in 2017 after Howard Schultz, the longtime risktaker CEO, stepped down (La Monica, 2019). Johnson has been with the company since 2009, and he has steered the company through several scandals, responding to a 2018 incident of racial bias in a Philadelphia store by closing all stores for one day to put employees through racial bias training (La Monica, 2019). In addition to demonstrating the ability to find and overcome problems, Johnson is fulfilling his role as a caretaker CEO by guiding the company through technological advances in the Starbucks app, a partnership with UberEats, and expansion into China (La Monica, 2019). Kevin Johnson has experience with Starbucks, and he is suited to help it go through its maturity phase.

Strategy Alternatives

After considering the internal and external environment, four strategies could be advantageous for Starbucks to pursue.

The first strategy would be for Starbucks to continue operating as usual. This would involve keeping the plans to build stores in both the United States and internationally. It would also include updating stores and continuing its retail line as is.

The second strategy alternative would be to focus solely on expanding internationally. As part of this strategy, Starbucks would adjust its international menu offerings and style stores to best represent the consumers in each locale.

A third strategy would be to diversify store types in the United States instead of expanding internationally. This would mean updating traditional stores to enhance the third environment setting that Starbucks tries to provide, as well as potentially closing some traditional stores to open express stores and drive through only stores.

Fourth, Starbucks could work on growing its retail product line instead of building new stores. This would be accomplished through the use of an exclusive agreement with retailers such as Target for their ready-to-drink lines and Sur La Table for their coffee makers and other equipment.

Evaluation Criteria

Based on Starbucks' position as a mature company, important evaluation criteria will be profitability ratios, growth predictions, market share, and customer satisfaction.

Relevant profitability ratios, given the goals and strategy options, are net margin and free cash flow. Net margin measures the profit derived from sales, and Starbucks has a net margin of 11.98 percent (Yahoo Finance, 2019). This is roughly twice the industry average net margin of 6.33 percent (Reuters, 2019). Net margin indicates that there is sufficient net income to pursue opportunities outside of normal operations. Another relevant measure is the amount of free cash, which represents the amount of cash the company has available for reinvestment or distribution of dividends. Starbucks has a free cash flow of $1.26 billion (Yahoo Finance, 2019). This amount would allow the company to pursue other projects and still distribute dividends to shareholders.

As a mature company, growth predictions and market share are important metrics. If the company's growth predictions are low, the market could be expecting them to enter the decline phase of the business life-cycle. Starbucks is expected to grow 11.6 percent in the current year, 12.6 percent in the next year, and 12.25 percent over the next five years (Yahoo Finance, 2019). The steady growth expectations indicate that the company should stay in its maturity phase for at least the next five years. Market share is also an important indicator of the company's success at present, and Starbucks has the largest market share in the coffee and snack shop industry (IbisWorld, 2019). The high market share puts Starbucks at an advantage over competitors and shows that it has higher sales than other firms in the industry.

Customer satisfaction is a measure that helps companies decide if operational changes are necessary. Net promoter score is used to measure customer experience, and Starbucks has a net promoter score of 77 (Relationwise, 2018). The highest net promoter score possible is 100, and Starbucks' score puts the company in a very high position across all companies. It shows a high level of customer satisfaction.

Strategy Recommendation

Based on the evaluation criteria, Starbucks should pursue its existing strategy. The high market share, profitability, free cash flow, and customer satisfaction metrics show that the current strategy is working well. The company is financially sound and can handle the investment that building new stores requires both domestically and abroad, as long as it is done over time. Also, the announced plans to expand internationally would help build brand value and gain additional market share. Starbucks has shown that its formula for profit and customer engagement has worked, and it should not depart from its current strategy.

Implementation

Over the next five years, Starbucks is supposed to experience high levels of growth. It currently has plans to build new stores in international markets and the United States. Over the next five years, Starbucks should look into further penetrating the Chinese market, as it only experienced small growth in the last fiscal year, and there is potential for substantial revenue. There are only 3,600 stores in China, compared to the more than 14,000 stores in the United States, there is room for at least another 2,000 stores in China.

In the United States, Starbucks should first pursue updating its stores. Over the next two years, Starbucks should do remodels of its oldest stores to make sure that they are able to integrate the third environment experience with changing technology. It should also focus on looking at locations for its express stores and premium roasteries. These store types should be planned first for large metropolitan cities such as New York, Chicago, Atlanta, and Los Angeles. Any areas that are oversaturated by these additions should close traditional stores and have employees be moved to staff the new stores. After the first two years of operation, the performance of stores with the new format should be evaluated, and Starbucks should build more stores of this type. Eventually, the format should be tested internationally.

Contingency

There is always a chance that problems could arise when following a growth strategy. This chance is exceptionally high when working in foreign countries, especially China, where there are tight government regulations. The business applications for new stores could be declined, but due to the existence of previous stores in China, Starbucks should plan on using its contacts to help get their stores approved.

In any international market, there is a chance that the customers will not like the menu because it does not match the local tastes, and a local competitor could steal business. If this happens, thorough market research should be done, and products that are inspired by the local culture should be added to the menu in place of the most unpopular beverages on the menu. This should be done in a creative way that prevents the drinks from being the same as local coffee or tea shops so that Starbucks can maintain its differentiation advantage.

When looking at introducing new store formats to the United States, there is always a chance that there are not enough customers using the express stores to make them profitable. For this reason, the company should create a marketing campaign introducing and explaining the different format. The stores should be watched, and performance should be evaluated quarterly. Within two years of opening, underperforming stores should be closed, and a traditional store should be opened in its place.

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