

Starbucks previous and current performances economics essay



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The main objective of this report is to evaluate Starbucks previous and current performances to stipulate the potential situation of this biggest successful company in terms of coffee shops. In light of the facts that the company's main objective focuses on expansion into several marketplaces, this report attempts to recognize a likely future prospects for Starbucks. The report uses several analyses like analysis of Economic growth, Inflation rate and Interest rate to reach a comprehensible and usable conclusion for the opportunities and growth that can be used by Starbucks. The firm wants to deliver superior quality coffee by implementing high standards while maintaining the ethical standards in trading and expansion.

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COMPANY PROFILE

Overview and History

Starbucks is the leading retailer and roaster of high-quality whole bean coffee in the world. Starbucks buys whole-bean and ground coffee to roast and sell them across its 18000 company-operated retail shops which are spread out in around 60 countries. It also retails a wide range of fresh food items and ready-to-drink beverages alongside with its handcrafted coffee and tea products. In 1971 Starbucks opened its first store in Seattle's Pike Place Markets with the aim of delivering high-quality coffee beans to the neighboring bars and restaurants. The focus of Starbucks shifted in 1982 when Howard Schultz, the then marketing head, returned from Italy and tried to inculcate the principles of a strong bar culture which he observed there.

Schultz then opened up a new cafe named Giornale, which brewed coffee from these beans and later took over Starbucks' assets and renamed itself to <https://assignbuster.com/starbucks-previous-and-current-performances-economics-essay/>

Starbucks Corporation. The Starbucks Corporation's portfolio now incorporates brands like Tazo Tea, Seattle's Best Coffee, Frappuccino and Starbucks VIA Ready Brew (Starbucks Corporation, 2003).

Market Focus

Starbucks' main objective now is to maintain itself as one of the most respected and renowned brand in the world. To attain this goal, it is implementing controlled expansion of their retail and licensed stores targeting on the growth in countries outside of the US. Starbucks focuses on the young metropolitan adults and nine-to-five workforce of the urban regions and its neighboring districts. This segment consists of people having varied income and age group; they have erratic tastes and interests so are most eager and attracted towards trying out new products and innovations. Starbucks utilizes this fact and offers a wide range of products that fulfill their different demands. The biggest coffeehouse company has its major market is in the United States where states like District of Columbia, Washington, Nevada, Colorado and California have the most number of Starbucks outlets (StateMaster. com, 2003-2013).

Market Share and Competition

Food & beverage businesses try to increase their influence and profits by nursing a large number of licensed stores. However, as of January 1, 2012, Starbucks had 9, 085 company-owned stores and 8, 159 franchised stores making it a total of 17, 244 stores (Trefis, 2012). The main competitors for Starbucks in the U. S. are Dunkin Donuts, Peet's Coffee, Caribou Coffee and The Coffee Bean & Tea Leaf (Forbes. com LLC, 2012). According to IBISWorld an industry research firm, in 2011 Starbucks had almost 32. 6% of market <https://assignbuster.com/starbucks-previous-and-current-performances-economics-essay/>

share of coffeehouse in United States as compared to its closest competitor Dunkin' Brands Inc. which only has 16.1% of market share (Columbus). The bulk of its revenue is generated from the domestic U. S. market, which is estimated to be approximately \$2.1 Billion as compared to its overseas revenue of just \$640 Million (Haymarket, 2011).

Achievements and Mission

Starbucks has celebrated many accomplishments apart from maintaining its #1 spot for best coffee in the quick refreshment categories and fast food. It is one of the 'world's most ethical companies' (starbucks.com). It has banked on the "Starbucks Experience" by providing a relaxing and comfortable atmosphere with excellent customer service and innovative strategies. The present mission statement of Starbucks is 'to inspire and nurture the human spirit by one person, one cup and one neighborhood at a time' (Starbucks Corporation, 2012).

COMPANY ANALYSIS

U. S. experienced an increase in the number of coffee shops by 70% between 2000 and 2005, which brought the total count of coffee shops to 21,400. MINTEL predicts that the number of retailers could keep on rising till there is a coffee shop for every 10 thousand Americans. Contributing for 73% of the market value, Starbucks is the most dominant force that has led to this monumental growth (Research Portals Ltd., 2011).

As Starbucks' rampant evolution has formed an ever-increasing need for premium coffee it has opened up the market for other competitors also as they have already done the research work of building up a coffee culture in

that area. However its growth can be considered as a mixed bag of blessing as it progressively owns a bigger market share and therefore prevents individual and other smaller vendors from building into the market.

As such, individual or smaller vendors are unlikely to present any kind of big threat to Starbucks. The important rivalry may come in from other giants like Burger King and McDonalds, that can fully overshadow the Starbucks chain also they have already started to elbow for a bit of the coffeehouse action by launching their own premium coffees. As Americans already visit these restaurant chains on an average of 7 times in a month, they appear completely placed to provide a true alternative to Starbucks (Research Portals Ltd., 2011).

Starbucks can be given credit for bringing the coffee to the public while maintaining premium costs of an average of \$4. 36 for a cappuccino. A median income American household of just over \$46, 000 spends around 2 % of their income on coffee over the course of the year. The working force between the ages of 18 and 34 are shelling out about \$24. 74 per week on coffee compared to \$14. 15 for the over 45 cluster (Anderson, 2012). All these factors make the demand curve of the firm inelastic. The current and future spending of customers can be predicted as increasing from the graph so Starbucks can easily mark up its prices to earn more profits in the future.

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Source: (Trefis, 2012)

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MARKET STRUCTURE ANALYSIS

Perfectly Competitive Market

There were about 20, 000 coffee shop businesses in the United States with combined revenues of 10 billion US dollar in 2011. Obviously, Starbucks is located in perfectly competitive market that there are a lot of competitors who sell identical products and they can easily enter or leave this market. In the perfect competition market, any of companies does not have enough capacity to influence the price of the products. It can only be determined by the quantity of demand and supply.

Previously, Starbucks merely competed against some small-scale coffee retailers, but currently they have to compete against varying size of coffee shops and other outlets. In particular, Starbucks must compete against McDonald's and Dunkin Donuts, which are two large companies in the fast food industry who have entered the coffee segment. Therefore, the price will change with the new entrants in the market.

As the graph represents, in a perfectly competitive market, if the total revenues are more than the total cost at the profit-maximizing output level, the firm is generating economic profits. Some potential firms realize the profit scope in the market and will enter, thus the number of suppliers increase and the competitions increases as well. This increase will eventually lead to the decrease in price, so at the cross point, the average cost is equal to the average revenues. This means no economic profit for any firm in the market. In order to generate profits, firms should focus on the short run.

For the Starbucks, it can be considered the life cycle of their coffee or merchandise. For example, Starbucks adds some flavor of packaged-coffee to peak up the sales in 2010. However, for Starbucks in the long run, it is better to maintain the quality of their coffee so that it can sustain the brand value and the loyalty from its customers while taking some actions to reduce the costs.

Economies of scales

Economies of scales means the scope of production, an increase in production makes the average cost decrease continuously to a certain level. As coffee is a basic beverage for the people of the United States it has been regarded as a good sample of economies of scales in food and beverage industry. According to Coffee Drinker Statistics in 2012, there was a strong increase of demand for coffee with Macchiato surging in popularity by 50% since 2007 (SBDCNet News Magazine, 2012). So it is an incentive to coffee suppliers to produce and sell more coffee. On the other hand, coffee suppliers can expand the number of shops and advertisement that is probable to increase the total sale revenues and can help them to reduce the average fixed costs. Therefore, as a large coffee manufacturer, Starbucks can be considered to produce a lower total cost according to economy of scales in a long run.

The Cost Factors

The short-run total cost of a business fall into two distinct categories, variable cost and fixed cost. Variable cost is not fixed and changes with the level of output in a short term, while the fixed cost is constant no matter how the level of output changes.

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Variable Cost

For Starbucks, when it produces products and operates business in a short run, it incurs variable costs like the cost of the coffee bean and milk, packaging and consumables with coffee. According to the Starbucks annual report in FY 2011, the total variable cost including occupancy cost is \$3, 093. 9 million. The total variable cost increased 6% compared with the total variable cost that was \$2, 906. 1 million in FY 2010 (Starbucks Corporation, 2012). This cost increase was primarily due to the increasing of raw material such as the milk and also the sales volume.

Fixed Cost

The fixed cost of Starbucks, it is considered mainly as the stores rent, the expense of utility bills and the salary of staff. The total fixed cost was \$3381. 5 million in the October of 2011, which was higher than the last year. The total fixed cost is mainly includes store's operating expense (\$2891. 3 million) and depreciation and amortization expense (\$343. 8 million) (Starbucks Corporation, 2012).

MACRO-ECONOMY OF UNITED STATES

Economic Growth

Economists usually use GDP or GDP growth rate as an indicator to analysis one country's economic growth because GDP is one measure for calculating the amount of output of goods and services produced by labor and property over a specific period of time.

The calculation is:

$$\mathbf{GDP = C + I + G + (X - M).}$$

Consumption, C

Investment, I

Government Purchases, G

Net Exports = Exports (X) – Imports (M), or X – M.

In term of economy or military, America is a superpower in the world today. However, with the Global Financial Crisis due to the housing bubble in 2008, United States' economy entered into a recession. As the graph shows, the GDP growth rate reduced to the lowest point of -8.9% in the fourth quarter of 2008. The aftermath of Global Financial Crisis even impacted the 2009's growth rate. Further, with some new economic policies that were presented during the election by President Obama, the United States' GDP growth rate is slowly recovering. At the third quarter of 2012, the GDP growth rate increased to 3.1% and the value of GDP is pointed at 1,509.4 billion US dollar (Mataloni, Hodge, Stewart, & Aversa, 2012).

Source: (Trading Economics, 2012)

In addition, personal consumption expenditure, private inventory investment, federal government spending and residential fixed investment made positive contributions to the increase of GDP. Only the exports had a negative contribution from non-residential fixed investment side. Further, except food and energy prices, the price index for gross domestic purchase, which measures the price paid by United States citizens, increased 1.2% in the third quarter.

Unemployment Rate

Until 2011, the population of United States was nearly 313 million people and among them about 67% was in the age group of 15 to 64 years. In addition, around 82% of total population was living in the urban areas and could be regarded as the labor force. (CIA World Factbook, 2012) However, because of the Global Financial Crisis, the unemployment rate rapidly increased from 4.5% to 10% in just two years. It forced many companies to close down leading to a lot of unemployment. Now the unemployment rate has decreased slightly and is at 7.7% at the end of 2012.

Source: (Trading Economics, 2012)

The government of the United States realizes that in order to recover the economy, they have to take some actions to reduce the high unemployment rate in recent years. As a result, it is probable for the government to take further actions on easing of the monetary policy. Only in this way, there can be an increase in the income of residents and reduction in the unemployment rate. With the increase in the income, people will be willing to consume more which will in turn increase the overall output of the economy.

Inflation Rate

Inflation rate means the general level of prices for goods and services; if the rate is rising then subsequently the purchasing power is falling. It is calculated by using consumer price index (CPI) so that it indicates the consuming power of residents. According to a country's economic context, a high inflation rate is acceptable if there is proportional increase in per capita

income. But when severe inflation occurs, the central bank will try to stop it so that can control the excessive growth of prices.

Source: (Trading Economics, 2012)

Historically, the United States inflation rate is recorded at around 3.4% average. The graph shows that in recent 5 years, the highest point was recorded at 5.5% and the lowest point was recorded at -2.1%, during this time there was a dramatic reduction from highest point to the lowest point. The new figure of inflation rate reported is 1.8% at the end of 2012. Moreover, the most important categories in unadjusted CPI for all urban consumers are shelter, which was 31% of the total index, and food account was just 14%.

Interest Rate

Source: (Trading Economics, 2012)

The change of interest rate is based on the domestic economy of a country. If the economy is in recession time the government will reduce the interest rate, and on the other hand, if the economy is on the boom, the government is willing to increase the interest rate.

Since 2000, there were three periods for United States' interest rate, the period of interest reduction (from May. 2001 to Jun. 2003), the period of interest increase (from Apr. 2004 to Sep. 2007), the period of interest re-

reduction (from Sep. 2007 to 2009) due to the property market decline. Since 2009 until now the interest rate is stable and was last recorded at 0.25%.

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Exchange Rate

With the development in international trade, there is a higher frequency of export and import trade among countries. China is one of important import trading country for United States, the exchange rate between two countries affects the trade directly. As the graph represents, the exchange rate for U. S dollar to RMB decreased from 2008 till now. This trend will impact the United States' import, because the companies need to pay more to purchase products from China.

Source: (OANDA Corporation, 2012)

However for the coffee industry the top import comes from Brazil (Helium, Inc., 2009). In the last 5 years, the average exchange rate is 1. 95, which peaked to 2 in 2009 and touched at the lowest point of 1. 68 in 2011.

Source: (OANDA Corporation, 2012)

In conclusion, from 2009 to 2011, coffee producers had to pay more to import coffee bean to the United States.

Future of the Company

From the above analysis we can infer that overall conditions for Starbucks will become favourable for their growth if their strategy is on the right track. As Starbucks provides premium quality coffee, which has withstood during the recession and is making profits also, hence it can focus on expanding in the future. On the corporate level they can lower their price by making a new genre of coffee using cheaper beans to increase their sales by encompassing the people who opt for economically feasible products. This will lead to an

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increase in the ever-increasing demand for Starbucks coffee and then at business level they can implement Focus Strategy to breakthrough into new and cheaper international markets. Starbucks should also find out new exporters of coffee beans who have lower exchange rates so as to reduce their import cost. Overall they should take the necessary measures to ascertain their dominance in the market while providing the best quality coffee.

Conclusion

Starbucks achieved its success by maintaining its standard on a few factors.

Brewing Exceptional Quality coffee

Providing Excellent service at their stores

Worldwide Expansion of new stores to reach everyone

These elements have boosted the sales and reputation of Starbucks among the coffee enthusiasts. Starbucks faces a very aggressive rivalry with long established and rapidly growing firms in all areas of its business activity. The company is still performing strongly and is in a good position to expand its business specifically after effectively climbing out over the after-effects of the financial crisis. Starbucks has strong financial ability and when backed up with adequate strategies it can surpass all its rivals to continue to be the dominant market leader in high quality coffee purveyor.