Starbucks delivering customer service

Business, Company

Lifetime Value For Unsatisfied, Satisfied, And Highly Satisfied Customers. The story of Starbucks ' transformation from a small independentcoffee shoptucked away in a corner of Seattle’s Pike Place Market to a cultural phenomenon pning the globe is legendary. A number of factors have been attributed to the success - one being a keen understanding of its patrons. There are multiple methods used to obtain customer information and the value derived therein. Customer lifetime value is one. Customers are assets, and their values grow and decline. Segmenting customers based on their lifetime value is a powerful way to target them because marketing mix activities can then aim at enhancing customer value. Roughly translated, customer lifetime value is the projected profits that a customer will generate during their lifetime. We used the case data to segment Starbucks customers into three distinct categories of unsatisfied, satisfied, and highly satisfied. Fortunately, the case provided some useful data to make our initial assumptions about the stream of expected revenues from each category. The data allowed us to calculate the annual expected revenues by taking 12, the number of months in a year, times the product of each component given in Exhibit 9 for each category of customer.

Unsatisfied	Satisfied	Highly
$ 199.74	$ 921.	78$

To derive the CLV it is necessary to determine the profits. This requires taking costs against the expected future revenues. The expected costs are

typically any amount incurred from attracting, selling, and servicing customers. The best representative cost of servicing the customer from the given data was the gross margin from Starbuck's financial statements. After all, this number reflects the true costs incurred in servicing each customer, while leaving out extraneous expenses such as depreciation and other corporate overhead that have little relation. The average of the five years offinancial statementdata was used for the margin to take against revenue. The figures below represent the CLV for each category using a discount rate of 12% to give the present value. A discount rate between 10% - 20% is typically used in these applications. Starbucks is a mature company at this stage of development and the cost of capital is likely to be toward the lower end of the spectrum.

Discount	Rate 12% CLV	Undiscounted
$ 113. 55	$ 524. 03	$ 1, 801. 94

Finally, we calculated the annual CLV for each category to provide information for our upcoming problem facing Starbucks about investing in increasing staffing levels. The annual amounts were derived by annualizing the products of visits/month and average ticket size/visit.

For comparison, our group also decided to calculate the textbook version of CLV by taking the average retention rate of 75% derived from Exhibit 8 and inputting it into the formula used in the text. We used the same discount

rate, 12%, and took that rate times the product of the number of Starbucks visits/month and average ticket size annualized.

CLV = m * r/(1 + I – r)

Exhibit 8 % of Starbucks' customers who first started visiting Starbucks . . . In the past year27% 1–2 years ago 20% 2–5 years ago 30% 5 or more years ago 23% Average25% $40 Million Investment In Improving Its Customer Service Using the data provided from Exhibit 3 in the case in regards to sales data broken down for each company-operated store in North America we derived the figures in the table below.

	Daily	Weekly	Monthly	Yearly
	$2,194	$15,400	$66,733	$800, 800
Average ticket/visit	$3.85	$3.85	$3. 85	$3. 5

One assumption made was the investment in improving customer service would be restricted to North American stores (4, 574) from our calculations regarding the forecasted cost of $40 million. As mentioned in the case, " the company had plans to open 525 company-operated and 225 licensed North American stores in 2003. " Consequently, these were the figures used to determine the forecasted North American store growth in 2003, and the

same growth projections were made for subsequent years. Additionally, using the customer count derived from the calculations in the previous table we projected the change in customer count by using the same retention rate of 75% calculated from Exhibit 8 to determine the amount of retained customers. This is also supported by the fact the Starbucks' cannibalizes its existing store revenue by opening new stores in geographically clustered markets. But this is offset by the total incremental sales associated with new store concentration. That figure was then used to provide the new customers by taking (1 – 75% = 25%) the percentage times the retained customer count.

Thereby, our total projected customers equaled the sum of the two and those amounts were continually projected forward. As shown, the growth in stores allows for a considerable reduction in the per store cost over the projected period. The initial acquisition cost was made by simply dividing the initial $40 million cost by the number of stores in 2002. From the information provided on Page 11 Fig A – Customer Visit Frequency, we calculated the customer base for each satisfaction level. Added to this information was the data derived from the prior table to break out the forecasted revenue stream less the acquisition cost to arrive at the profits made from improving customer service. To increase the profitability based on the CLV data, the maximum bang for the buck is gained by increasing the customer level from satisfied to highly satisfied. By making this switch, Starbucks not only will see an increase in average ticket size from $4. 06 to $4. 42, but the frequency is also increased from 4. 3 to 7. 2 visits per month. All gains yield an additional $98 in incremental gross profit per every customer moved up

in satisfaction. Additionally, customer life increases from 4. 4 years to 8. 3 years.

As shown in the table below, it makes more sense to pursue after switching satisfied customers to highly satisfied customers as the NPV is far greater than the alternative. Using the NPV from the table and improvement cost for each store we can calculate the minimum number of customers that we need to switch in 2003 per store.

The minimum number of customers to be switched in 2003 = Improvement cost / NPV of satisfied to highly satisfied. = $7, 513/$497 = 16 customers/store = 16 * 5, 324 stores = 85, 184 total customers. 31

As Starbucks expands and builds more stores, improvement cost per store that is needed is reduced. This, in turn, has a direct effect on reducing the number of customers it needs to switch up one level. Qualitative assessment of Starbucks' challenges Expectancy-Value Model. There is a direct relationship between customer satisfaction and a number of visits and revenue which eventually leads to higher profits, Starbucks' should raise the customer satisfaction levels of its current customer base by making them visit stores more frequently. By using key customer attributes from Exhibit 10 and the consumer weights which was given in Exhibit 11, we can use the expectancy-value model to see what are the perceived values to the customer. We can then rank the attributes that consumers would value the most. The expectancy-value model shows that faster service is not the highest in perceived value to consumers. There are others that rank higher. Specifically, Starbucks should focus on treating the customer as a valued consumer by rewarding the consumer with free cups of certain coffees after

so many purchases. This would surely build moreloyaltyto their brand, especially among both the newer and older customers.

Starbucks can achieve this by doing one or more of the following:

- Prices and Promotions – Since Starbucks' typical customer profile is evolving, the company should look into running promotions such as discounted prices or a free drink after so many numbers of visits which could generate additional revenue and possibly increase the average ticket size and customer life for both unsatisfied and satisfied customer level as well as build loyalty among newer and older customers. Improve value to customers with friendly staff – Knowledgeable staff who offer attentive service by greeting and knowing regular customers as well as remembering their drinks would help to improve the value proposition for Starbucks'. This will also try to bridge the gap between Starbucks and various other independent specialty coffee shops.
- Cleanliness - Starbucks should ensure that the store is clean at all times (i. e. , restrooms, countertops, trash cans, seating areas, etc. as store cleanliness was ranked as key attributes in creating customer satisfaction (Exhibit 10).
- Convenience – next on the list is convenience. Starbucks' could continue to offer customized drinks and further promote sales of its SVC cards to help customers pay for their concoction at their convenience.
- Improve the customer snapshot measuring techniques to strike a balance in measuring customer satisfaction levels.

- Improve the quality and variety of coffee. Explore additional opportunities to earn peripheral revenues in selling pastries, sandwiches, lunch menus, or even liquor.
- Study in making store atmosphere more conducive to ethnically concentrated geographical locations.

Reference

1. Ho, T. H. (2006).
2. Incorporating Satisfaction into Customer Value Analysis: Optimal Investment in Lifetime Value. MarketingScience, 260-277. MOON, Y. (2006).
3. Starbucks: Delivering Customer Service. HarvardBusiness Review.