

# Key areas that affect profitability and continued growth marketing essay



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The objective of this report is to discuss key areas that affect profitability and continued growth at Starbucks and to provide strategic recommendations.

This report can be used to analyze current strategic decision making effectiveness as well as provide a roadmap for Starbucks continued success.

### Company Background

Starbucks is a publicly traded company (SBUX) founded in 1971 in Seattle, WA and is a purchaser and roaster of whole bean coffees. Starbucks produces and roasts high-quality whole bean coffees and sells them along with food items and coffee related accessories through over 7000 plus company operated retail stores. Starbucks also licenses its trademark through other channels known as specialty operations.

### Industry Definition

Starbucks has a variety of industry code classifications including SIC code: 2095 -roasted coffee and NAICS code: 311920 - Coffee and Tea Manufacturing. Starbucks is a specialty eatery serving both food and beverage products.

### Mission Statement Analysis

Starbucks mission statement is simple; to inspire and nurture the human spirit- one person, one cup, and one neighborhood at a time. Backing Starbucks mission statement are its six principles on how they operate found in Appendix A. These principles encompass their product, customers, partners, stores, communities, and shareholders and provide the company vision. A well defined company mission statement should include the <https://assignbuster.com/key-areas-that-affect-profitability-and-continued-growth-marketing-essay/>

company's product, market and areas of emphasis that reflects the values of the strategic decision makers in the company (Regis University, 2009).

Pearce and Robinson define a mission statement as “ a unique purpose that sets a company apart from others of its type and identifies the scope of its operations” (Regis University, p. 18).

As a result of our analysis, we found that Starbucks mission statement coupled with their principles defines the scope of the company operations and aligns with there current strategies.

External Environment

## **Porter's Five Forces Analysis**

The Porter 5 forces analysis is a framework for industry analysis and business strategy development developed by Michael E. Porter in 1979.

Michael Porter's framework sees five major factors that influence a business: threat of substitute products, bargaining power of suppliers and buyers, rivalry between competitors and threat of new entrants to a market. The porters five forces model will help identify where improvements can be made through the current competitive force, threat of potential entrants, bargaining power of buyers, bargaining power of suppliers and the threat of substitute products. Using Porter's framework as a guide, Starbucks should consider the following:

Power of Suppliers: Starbucks prides itself on its guiding principles one of which states, “ Our Coffee-It has always been, and will always be, about quality. We're passionate about ethically sourcing the finest coffee beans, roasting them with great care, and improving the lives of people who grow <https://assignbuster.com/key-areas-that-affect-profitability-and-continued-growth-marketing-essay/>

them.” Therefore, in keeping with their mission and principles, Starbucks must ensure that the type and quality of coffee it offers is always the same. This means they would use the same suppliers that integrate their standards.

Coffee is one of the largest traded commodities in the world. Starbucks is directly affected by Central America in terms of production of the Arabica beans they purchase. The bargaining power of suppliers to the specialty coffee industry would be exerted by either an increase in the price of the beans which are used in the production process, or by a threat of decline in the quality or quantity of the coffee beans themselves. An over-populated market could also give the suppliers more bargaining power. Starbucks needs to be aware of supplier power and potential price increases.

**Power of Buyers/Customers:** A buyer group is powerful if the industry’s product does not save the buyer money (Pearce and Robinson, 2007) This is a plus for Starbucks as their coffee products are higher in price and considered a luxury brand. Starbucks is much more concerned with the quality of their product versus price. However; the other consideration is small local coffee companies that were around before Starbucks took over the marketplace. These smaller coffee shops may have their core customers who will not give their business to anyone else.

**Available Substitutes:** Starbucks must be aware of substitute products. Given the current grave economic crisis, consumers are vying towards less expensive alternatives than the luxury coffee Starbucks provides. This effect could alter Starbucks current pricing strategies. As more substitutes become

available, the current pricing model would become more elastic since customers have more alternatives. Potential substitutes include bottled water, healthy water/juice drinks, and at home espresso machines.

**Current Competitors:** While companies like Dazbog and Caribou Coffee appear to be the most obvious competitors, McDonalds and Dunkin Doughnuts are Starbucks top competitors. Both these organizations can compete with Starbucks in terms of sandwich items and coffee related products. More of a concern with these two competitors is their pricing models. Both competitors are priced less than Starbucks products.

**Threat of New Entrants:** Starbucks provides a luxury good that consumers often scale back on when they want to save money. In 2007, Starbucks saw its shares fall more than 30% partly down to customers deserting it for cheaper rivals. As McDonalds and other chains like Dunkin Doughnuts realize the money in luxury coffee more companies will begin to enter the marketplace offering similar product lines for less cost.

## **Remote Environmental Factors**

**Economic-** Economic factors concern the nature and direction of the economy in which a firm operates. Current recession trends imply a reason for concern for a luxury brand like Starbucks with regard to the company's financials.

**Social-** Promoting the health benefits of coffee remains a challenge for the industry and consumers are often confused with the myths propagated by the media. Social concerns regarding caffeine, and its addictive properties also need to be considered.

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Political-Current tensions in the Middle East and boycotts of American made products are strategic concerns for Starbucks globalization plans. Starbucks also imports their coffee beans and thus any changes in import laws should also demand special attention.

Ecological Factors- Starbucks also has a strong environmental mission statement. Starbucks promotes ethical sourcing, contributes heavily to their communities, as well as continually strives to buy, sell and use environmentally friendly products. Starbucks uses key performance indicators to be sure they are measuring the degree to which they fulfill their social and environmental responsibilities. Starbucks should maintain abreast of any changing environmental legislation that could impact their corporate strategies.

Technological Factors -Starbucks has been continually looking for ways to enhance the customer experience. They have also expanded their partnership with ATT. ATT offered consumers WiFi service in more than 7, 000 Starbucks locations in the U. S. in spring of 2008.

## **Industry and Competitive Environments**

When in a recession, luxury products tend to decline and coffee is no exception. Consumers don't find as much worth in spending \$4. 35 for a cup of coffee when they can purchase the same size coffee at 7-eleven for \$1. 75.

However, Starbucks has an immediate plan for continued growth including the introduction of its instant coffee line. " Despite the challenging economic environment, Starbucks is profitable, has a strong balance sheet and <https://assignbuster.com/key-areas-that-affect-profitability-and-continued-growth-marketing-essay/>

generates solid cash from operations,” said Schultz, CEO of Starbucks Corporation.

The company is also making strategic investments in key initiatives by:

Entering the \$17 billion instant coffee market earlier this month with the launch of Starbucks VIA™ Ready Brew instant coffee;

Growing its consumer products, licensed stores and foodservice channels; and

Focusing on disciplined global store expansion in key markets.

## **Operating Environment**

Pearce and Robinson (2007) stated, “ The operating environment factors in the immediate competitive situation that affects a firm’s success in acquiring needed resources.” Starbucks current operating environment includes threats from competitors and rising expenses including fluctuating costs of dairy products. Price increases could have a negative impact on traffic. As of 2007, Starbucks has less than a 10% share of all of the coffee consumption in North American, and less than 1% internationally.

## **International Environment**

Starbucks is an organization that operates in an international market both with regard to retail locations and use of international suppliers. Thus, Starbucks needs to consider the countries involved in its international partnerships and the impact it can have on their business strategies with regard to political, social, economic and legal locality concerns and events.

## Internal Analysis

“ SWOT is an acronym for the internal strengths and weaknesses of a firm and the environmental opportunities and threats facing that firm” (Pearce & Robinson, 2007, p. 153). Starbucks has several strengths, weaknesses, opportunities and threats that are listed in Appendix B.

**Strengths:** Key strengths for Starbucks include the value of their employees and their corporate culture. Starbucks considers its employees “ partners” which provides a sense of inclusion for those who work there. Also, Starbucks was one of the first organizations to offer full benefits for part-time employees. Another key strength for Starbucks is brand loyalty and name recognition. Howard Schultz, CEO, has created an every day item and turned it into a mega brand similar to Nike. Starbucks is on every street corner, in your local supermarket, and in your bookstores and campuses nation wide.

**Weaknesses:** A key weakness for Starbucks is weakened innovation and creativity. According to Schultz, the Starbucks “ experience” is about passion for a quality product, excellent customer service, and people. With over 4500 coffeehouses in 47 countries Starbucks coffee becomes somewhat of a commodity. In a February 2007 memo, Schultz warned top executives about over saturation of the brand. Diminishing growth opportunities are likely.

**Opportunities:** Starbucks is a global corporation that sells its coffee in more than 16, 000 coffee shops in more than 35 countries. Continued global expansion is an important opportunity. Starbucks has established relationships with PepsiCo, Barnes and Nobles, Dreyer’s Ice Cream and other major brands. Opportunities include continued co-branding with major  
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manufacturers of food and drinks that have greater potential and enable further global expansion. Finally, another key opportunity is the creation of additional coffee related products and an expanded menu.

Threats: Substitute products influence the demand for a company's product. More substitutes offer a bigger choice for customers and thus Starbucks has to be aware of potential substitutes available. Given the weakened economy, these substitutes become more desirable if they are a lesser cost than Starbucks offerings. With a weakened economy also comes an increase in purchasing cost for coffee related products and dairy products; both of which impact the return on investment and profits for Starbucks.

#### Resource Based View (RBV) Analysis

Resources are the “ distinct combination of assets, skills, capabilities and intangibles of an organization” (Pearce & Robinsons, 2007, p. 164).

Examination of Starbucks' resources can provide a method to analyze strategic advantages and assist with strategic planning. There are three basic resources reviewed when using this method; tangible assets, intangible assets, and organizational capabilities.

Tangible Resources-Tangible resources are the “ physical and financial means a company uses to provide value to its customers” (Pearce & Robinsons, 2007, p. 165). Examination of Starbucks balance sheet shows inventories make up largest portion of their assets at 692. 8 million of the 1, 748 billion in total current assets. Interestingly, cash and cash equivalents make up a mere 269. 8 million of current assets. Starbucks owns 5 Roasting and Distribution locations, 9000, company operated retail stores, 205, 000 sq  
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foot office building with 36, 000 sq ft plot of land totally 2, 956. 4 million in net assets.

**Intangible Resources:** A company's intangible resources are also important to the overall business advantage. Brand recognition is a key intangible resource for Starbucks. Starbucks reputation is positive and they are known for high quality coffee coupled with high quality customer service day in and day out. Starbucks has also used their brand recognition to introduce new products including bottled coffee drinks ice-cream products, and home espresso machines, and this intangible asset provides overall reliability that is difficult for competitors to penetrate. Other intangibles include - quality of locations; skill at citing new shops; employee training, skill at customer service, and morale; employer of choice-Forbes 100 Best Companies to Work for 2007, 2008.

**Organizational Capabilities:** Howard Schultz continues to strengthen Starbucks' top management team, hiring people with extensive experience in managing and expanding retail chains. Starbucks also maintains and continues to expand its ownership of desirable locations so location analysis is a capability which allows the company the ability to increase quality of the same input factors as their competitors.

### Value Chain Analysis

“ The term value chain describes a way of looking at a business as a chain of activities that transform inputs into outputs that customers value” (Pearce and Robinson, 2007, p. 158).

Primary Functions Include: High quality product, Ethical coffee sourcing and fair trade, global responsibility, and Baristas (quality of customer service). Inbound logistics: negotiation with coffee providers, purchasing, receiving, processing, distributing raw materials to service sites.

Support Functions Include: Coffee Master training program, desirable locations, and modern technologies and research and development. Plus traditional organizational support functions such as HR admin, accounting and finance, marketing, etc.

Strengths of the value chain for Starbucks include their high quality product and the sourcing and creation of their product. Starbucks is committed to ethical sourcing and fair trade. Starbucks is also globally responsible and has introduced a shared planet program thus producing a sustainable image. This differentiates their product from their competitors.

Weakness of the value chain for Starbucks include over saturation of the brand and diminishing growth opportunities due to buying out their competitors in prime real estate locations.

Financial Analysis

## **Liquidity**

Starbucks 2008

Industry Median

Current Ratio

0. 80

0. 89

Quick Ratio

0. 50

0. 50

A current ratio measures how well Starbucks is able to meet its short term obligations. A quick ratio measures the same, minus inventories. Starbucks current ratio aligns with the industry median which means their current ratio is considered a norm for the industry. Their quick ratio also aligns with the industry median suggesting that the company doesn't have too much of its liquid assets tied up in inventory and that they are not dependent on the sale of that inventory to finance operations. The ratios above generally imply that Starbucks is able to pay its short term obligations including items such as vendor bills, rent, utilities and payroll. This number also indicates that Starbucks is credit worthy because they have enough cash to pay off their short term debt and suggestive that they pay their bills on time.

## **Activity**

Starbucks 2008

Industry Median

Inventory Turnover

8. 3

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29. 2

Total Asset Turnover

1

1. 2

Inventory Turnover Ratio describes how quickly product is being sold. Starbucks inventory turnover is 8. 3. The industry median is 29. 2; suggesting that Starbucks is lagging in ability to turn over its inventory compared to its competitors. With a ratio of 8. 3, Starbucks essentially filled and sold everything on its shelves eight times in the year 2008, while the competition filled and sold 29 times.

Total Asset Turnover offers managers a measure of how well the firm is utilizing its assets in order to generate sales revenue. An increasing ratio would indicate that the firm is using its assets more efficiently. Starbucks 2008 ratio was 1, slightly lower than the industry median, and their 2007 ratio was 1. This implies that Starbucks hasn't changed the way it's using its assets. As this number also indicates pricing strategy and thus suggests that Starbucks has not changed its pricing strategy in the past two years of data.

## **Profitability**

Starbucks 2008

Industry Median

Gross Profit Margin

55. 30%

42. 16%

Net Profit Margin

0. 88%

7. 67%

Gross Profit Margin represents a firm's money left over after the cost of goods sold. Gross Profit Margin helps the company pay for future liabilities and future savings. Starbucks earned 10, 383 million in revenue for 2008. Their ratio of 55% indicates that they made roughly a little more than 50 cents for every dollar earned after the cost of goods sold was subtracted.

Net Profit Margin Ratio depicts how much of every dollar earned a company keeps in earnings. Starbucks is much lower than its industry median. A higher profit margin indicates a more profitable company that has better control over its costs compared to its competitors. As Starbucks markets itself as a "luxury brand" and charges on average four dollars for a cup of coffee, it's no wonder it's much lower than its competitors. This number can also indicate that Starbucks operating costs to produce their luxury coffee is increasing in cost. These items include dairy products, coffee beans, cups, syrups etc.

Finally Starbucks has a high gross profit compared to a low net profit. This could suggest that Starbucks isn't very good at controlling their expenses.

## Leverage, Earnings Per Share, Price/Earnings

Starbucks 2008

Industry Median

Debt to Equity

1. 28

1. 17

Debt to Assets

0. 56

The debt/equity ratio shows how much a firm has borrowed as a percentage of its stock equity. Often, the lower, the better. Starbucks ratio suggests that it is not borrowing heavily against the stock equity compared to its competitors.

Debt to assets ratio shows what portion of funds is being provided by creditors. Starbucks ratio shows that they are using very little credit.

### **Price to Earnings Ratio: 127**

According to Benjamin Graham, an investment is considered speculative stock when it has a P/E higher than 15, regardless of industry. Warren Buffet currently trades on this rationale. Using this rationale, that would suggest that Starbucks is severely overvalued. If we were to follow Benjamin Graham's theory on speculative stock, Starbucks should be trading at a 1. 80 per share. The industry average for P/E is approx 20-25 under current

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finance ratios. This number fluctuates based on current stock price.

Therefore Starbucks range should be from 2.40-3.00 per share.

## **Earnings Per Share-12 Cents (1 Q, 2009)**

Earnings Per Share shows how many dollars in profit were earned per outstanding shares of the common stock. The current EPS would show that Starbucks business has pulled back considered since 2008's quarterly reports which listed EPS at 43 cents per share. Therefore, based on this information, an investor could make the assumption that Starbucks debt is virtually equal to their income. And given one more or two more quarters of loss, the income would be less than the debt and would set the company up for a loss. This could generate from closed stores, overstock of inventory, and inflation.

### Strategy Recommendation

A generic strategy is a core idea about how a firm can best compete in its current marketplace (Pearce & Robinson, 2007). While Starbucks has many different strategies to consider, a generic strategy is currently recommended below given the research found in this report.

## **Recommended Strategy For Starbucks:**

### Differentiation

Starbucks can best achieve its long term strategies by continuing to strive to create and market unique coffee based products to varied customer groups through differentiation. The following direction points will be the basis for the competitive strategy:

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Rivalry will be reduced with successful differentiation.

As Starbucks markets itself as a luxury brand and experience, customers will be less sensitive to prices if Starbucks products are successfully differentiated.

Starbucks differentiation and focus strategy pushes customers to brand loyalty which will make it difficult for new entrants to overcome.

Starbucks currently exhibits and utilizes both differentiation strategy and the focus strategy. Starbucks has developed a customer loyalty that enables the firm to charge a premium price for its products. Starbucks demographic composition of their consumer base is narrow in direction. Their target consumer is middle to upper class and an educated coffee drinker who prefers quality and customer service over a low-cost price. This suggests that the firm is using a focus strategy anchored in a differentiation base because they attend to the needs of this demographic. Starbucks has differentiated themselves from their competitors by providing an image of the “luxury” coffee experience” and should continue this approach for long term growth and profit.

### Implementation

With regard to implementation, the following outline is recommended.

initiate specific functional tactics

outsource nonessential functions

communicate policies to all partners

design effective rewards

Starbucks can successfully implement their implementation plan by turning their strategy into action by following the steps below:

continue to provide and create new products perceived of higher value to buyers

create a new products business unit for streamlined product development introduction

analyze current economies of scale to reduce costs

continue to develop and motivate there “ partners” as they are there best assets.

continue closing of under performing stores as needed

increase global presence in prime locations to wash out weakening domestic economy issues

Evaluation and Control

Starbucks should evaluate these goals quarterly beginning in 2009 to avoid potential losses and provide for ample time for development of contingency controls. Starbucks can measure success by analyzing the following metrics with regard to new strategies and products:

Return on Investment

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## Net Profits

Partner Feedback-Starbucks values it's partners and considers and considers them one of their greatest strengths.

Customer Feedback-Continued customer satisfaction is key to the success of the business.

## Leadership and Ethical Concerns

Howard Schultz is a CEO who embraces change and someone who has a strong strategic plan. His vision is currently being announced in his transformation agenda which essential brings Starbucks backs to its roots. It is a simple plan and it is compelling. His ethical standards are directly tied to the culture of the company and at present is not a concern. Starbucks guiding principles found in Appendix A keep the company focus driven on providing high ethical standards across all business operations.