PennSEM

HIGH SCHOOL CATEGORY

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YouTube Link:

https://youtu.be/ULBzv_yBbDw?si=pYk_DpyQ2v55U2fI

Thesis Statement

Despite increasing Revenue and lower Production and Distribution (P&D) costs, Starbucks has missed earnings expectations **due to rising operating expenses in this fiscal year**. Additionally, while the **average ticket size is growing**, the **number of transactions are declining**. Revenue growth has declined versus previous years.
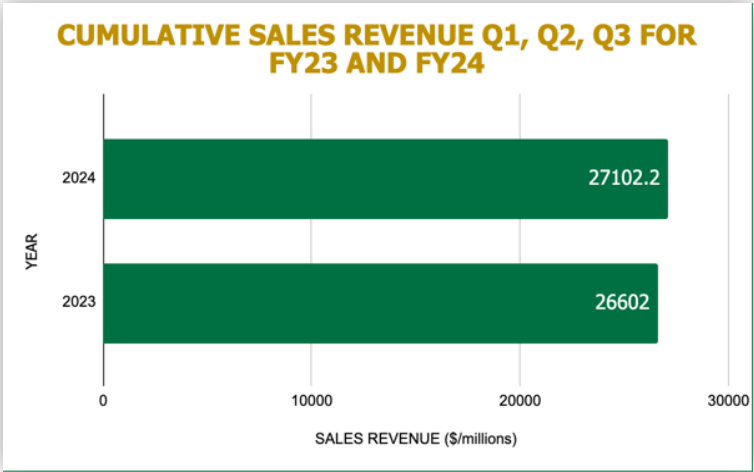

Figure 1
Source: Author

Figure 2
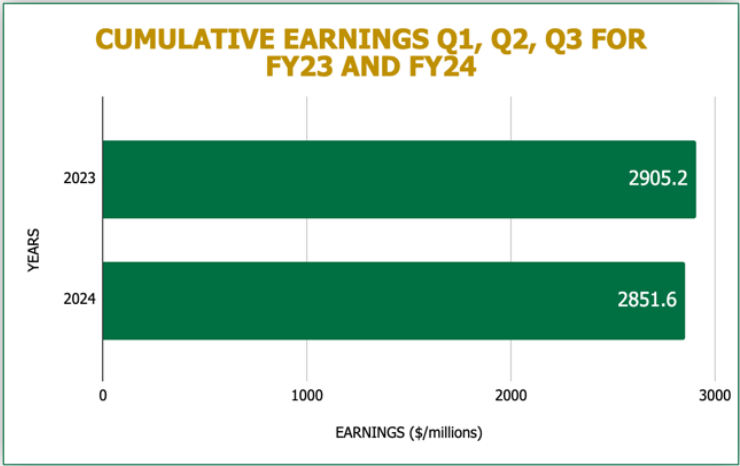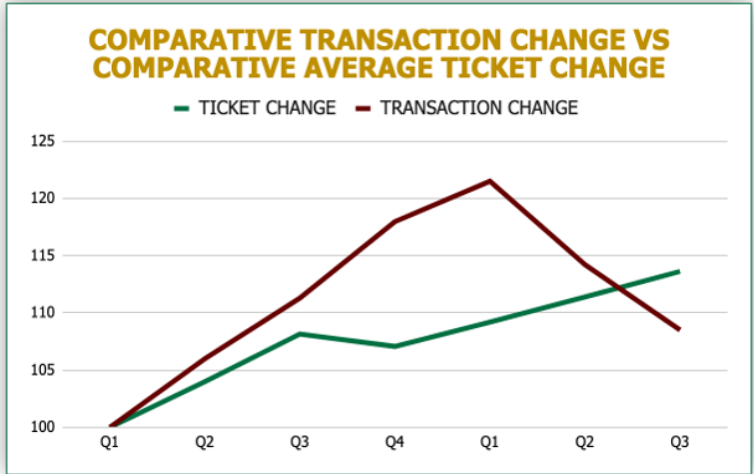Source: Starbucks Quarterly Reports

Figure 3
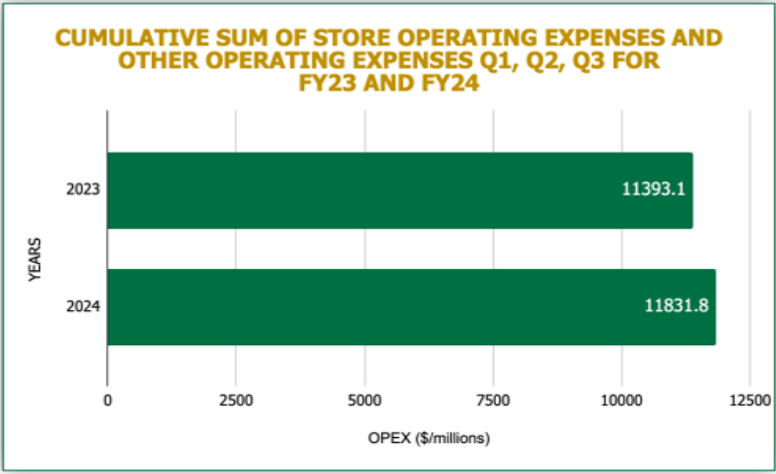Source: Author
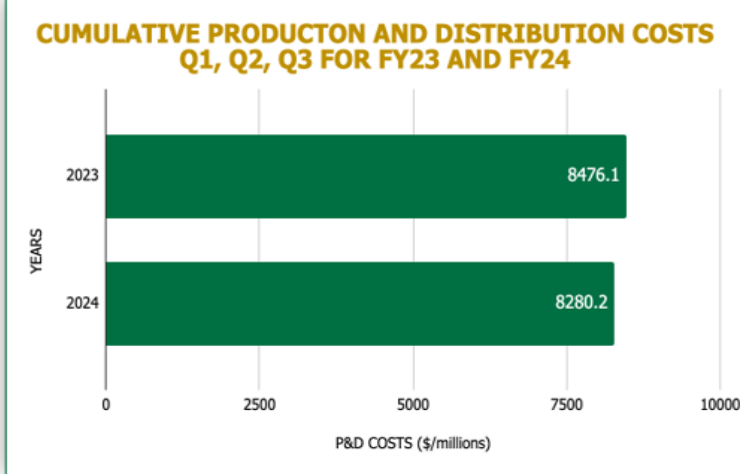

Figure 4
Source: sec.gov

Figure 5
Source: Author

Figure 6
Source: Author

Estimations v/s Actual Earnings Per Share

QUARTER	EARNINGS PER SHARE	GROWTH	FULL YEAR ESTIMATIONS
QUARTER 1	$0.90	Increased 20% YoY	15% - 20% Growth
QUARTER 2	$0.68	Decreased 7% YoY	Flat to low single digits Growth
QUARTER 3	$0.93	Decreased 6% YoY	Flat to low single digits Growth

Figure 7
Source: Starbucks Investor Relations

Figure 8
Source: Wall Street Journal

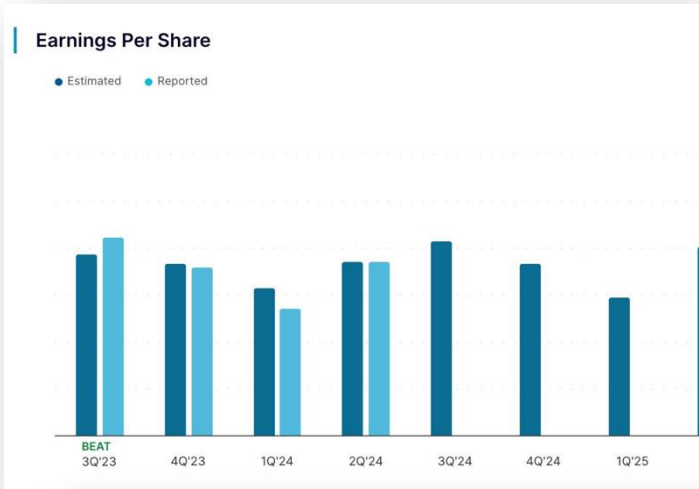| Currency: USD	Q1 '23	Q2 '23	Q3 '23	Q4 '23	Q1 '24	Q2 '24	Q3 '24	Q4 '24
Reported	0.75	0.74	1.00	1.06	0.90	0.68	0.93	—
Estimate	0.77	0.65	0.95	0.97	0.93	0.80	0.93	1.03
Surprise	-3.02%	+13.92%	+5.05%	+9.03%	-3.31%	-14.61%	-0.50%	—

Figure 9
Source: Trading View

Figure 10
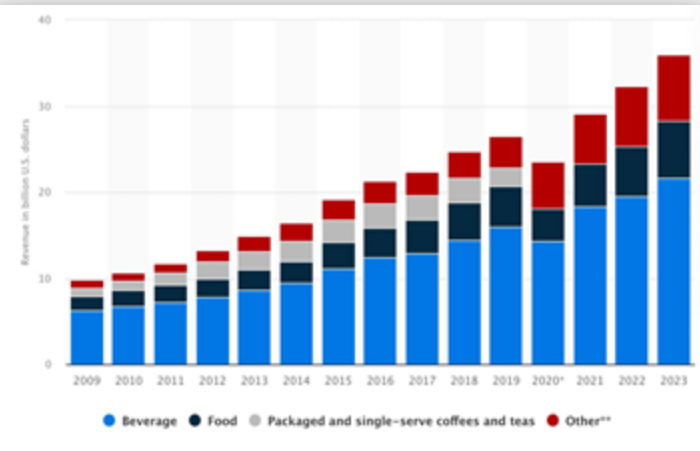Source: Nasdaq

1. Product Segment

Figure 11
Source: Statista

Starbucks has **increased their emphasis on both food and 'others',** decreasing the proportion of beverages. Despite this, the "others" section remains quite unexplored and narrow in terms of products.
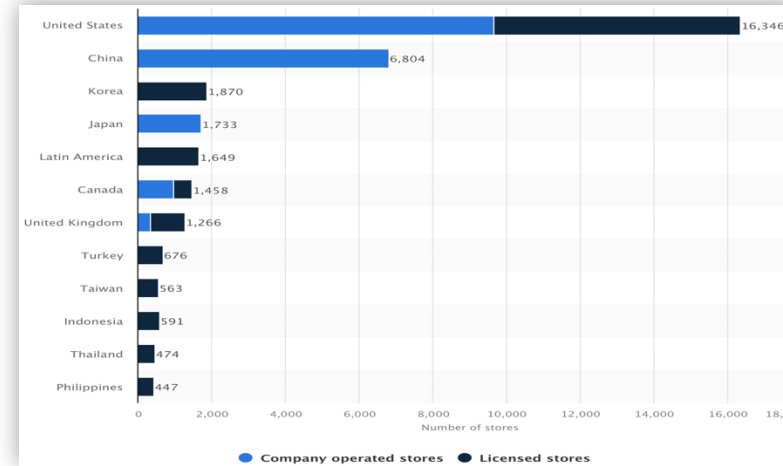
2. Geographical Segment

Figure 12
Source: Statista

United States of America and China consist of the largest store and revenue base for Starbucks (~80% of overall revenue)
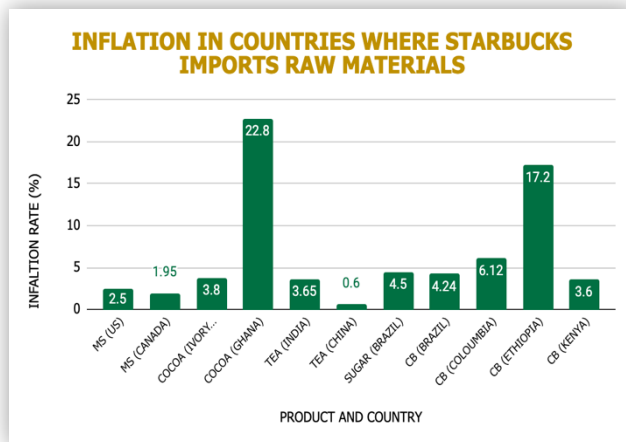
3. Inflation of Exporting Countries

Figure 13
Source: CNBC

Despite the high inflation rates, the decreasing Production and Distribution costs have **kept COGS low**.
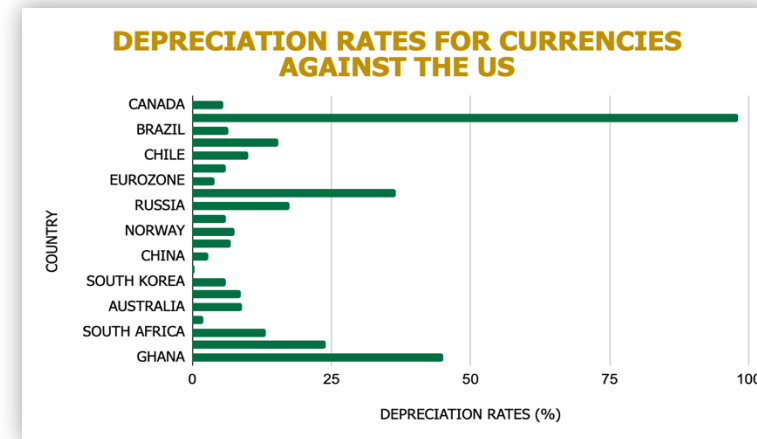
4. Depreciation Against USD ($)

Figure 14
Source: Starbucks Annual Reports

Revenue impacted by over $200 Million due to unfavorable currency

5. USA Market Analysis

a) While Starbucks is a market leader, **it has super-premium pricing,** and the recent hikes in prices (16-29% in the past year have led to **consumers migrating to competing coffee chains**.

b) Increase in unemployment rate resulted in a **decrease in demand for non-essentials**

c) **Increasing consumer skepticism** reflected by the Conference Board's Consumer Confidence Index falling from 105.6 in August 2024 to 98.7 in September 2024.

d) Starbucks has **higher prices than most of their competitors**, and with the aforementioned factors and substantial increase in prices, **loyal customers have switched to competitors**.

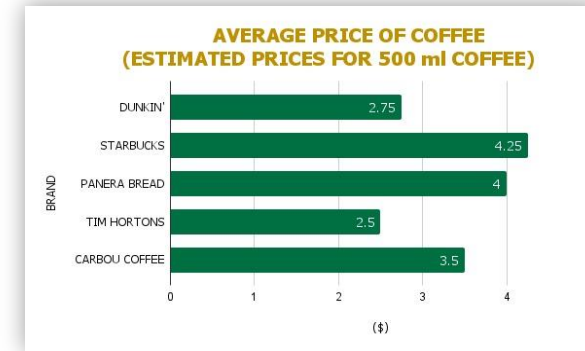Resulting in a 3% decline in comparable store sales at Starbucks in the third quarter of fiscal 2024.

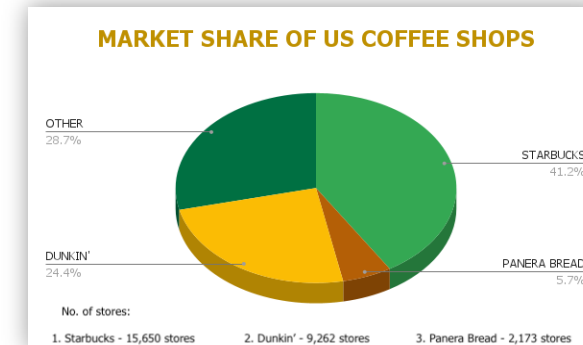Figure 15
Source: company websites

Figure 16
Source: CNBC

Figure 17
Source: Conference Board

6. Reducing demand in China

a) Starbucks is experiencing declining growth in China due to **competition from Luckin Coffee**.

b) Starbucks' average coffee price is around 30 RMB, while Luckin's is more affordable at 9-12 RMB.

c) **Luckin has over 18,000 stores in China, compared to Starbucks' 6,800**, making it more accessible.

d) **Luckin caters to local tastes**, offering unique options like coffee infused with Chinese liquor.

e) The recent economic slowdown has **shifted consumer preferences from premium coffee to more affordable alternatives**, further benefiting Luckin over Starbucks. Additionally, increasing rent in China leads to increased Operating Costs.

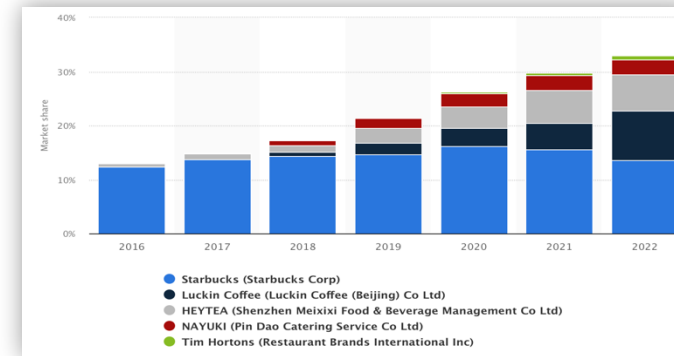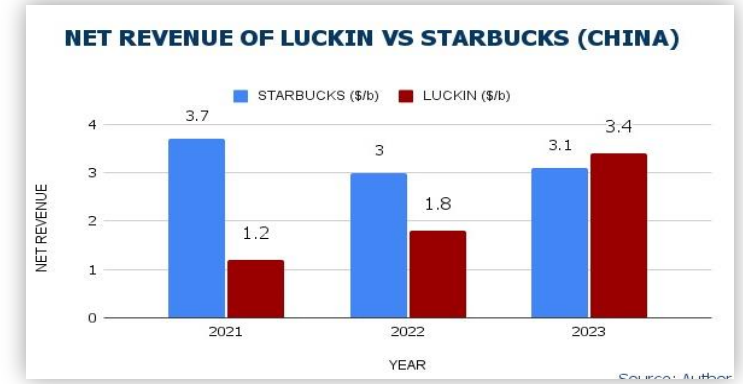Starbuck's Revenues are Declining in China

Figure 18
Source: CNBC

Figure 19
Source: CNBC

Figure 20
Source: Author
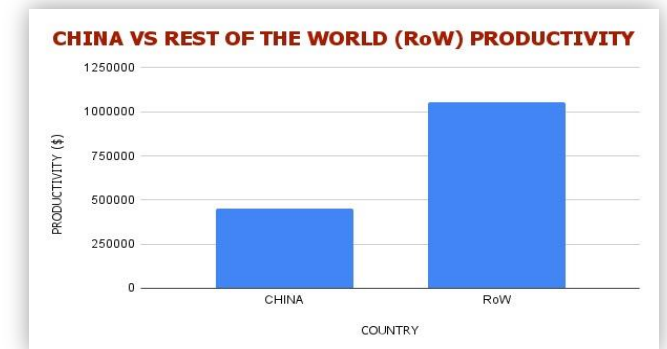
7. Decreasing Revenue per Store

a) It has been seen that even though the **total number of stores is increasing** in a linear manner, **sales revenue per store is fluctuating**.

b) This may be due to **large concentrations of Starbucks' stores in relatively small areas.**

c) This results in dilution of the consumer base amongst a larger number of stores rather than increasing the overall consumer base. **(Self Cannibalization)**

d) Furthermore, according to Starbucks' most recent quarterly report it is suggested that **new stores are driving larger proportions of revenue increments**:

> "Total net revenues for the first three quarters of fiscal 2024 increased $500 million, primarily due to higher revenues from company-operated stores ($541 million), which were driven by incremental revenues from 1,434 net new company-operated stores, or an 8% increase, over the past 12 months ($871 million)."

> *- Starbucks Quarterly Report Q3 FY24*

Figure 21
Source: Starbucks Annual Report

Figure 22
Source: Author

8. Operating Expenses

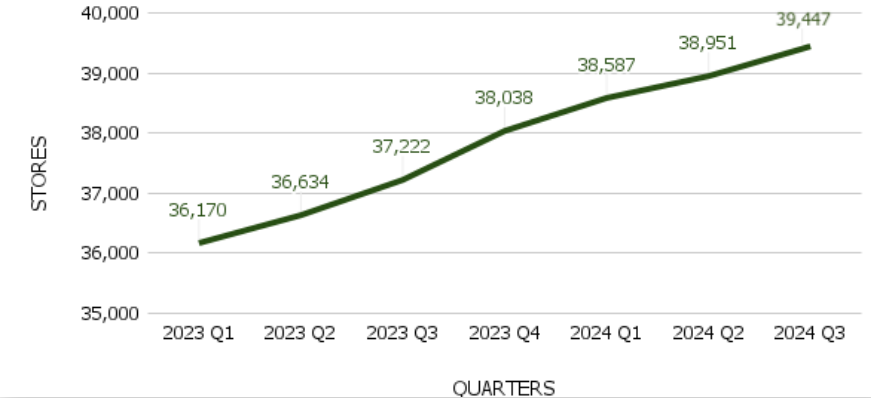*a) Store Operating Expenses*:

1) **Labor Costs:**

    i. **18.6% increase in Q1 FY24** due to higher wages, benefits, and staffing levels.

    ii. Increased costs from ongoing investments in safety measures and supplies.

    iii. **Expanding mental health support** and childcare increases expenses.

    iv. Increased spending on employee training programs.

2) **Maintenance:** Higher **foot traffic post-pandemic** drives up maintenance and repair expenses.

3) **Inventory Costs:** Supply chain fluctuations lead to **higher inventory prices** to maintain stock.
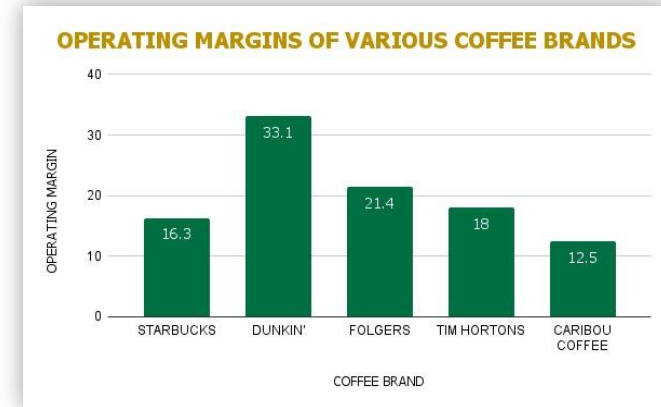
Figure 24
Source: CNBC
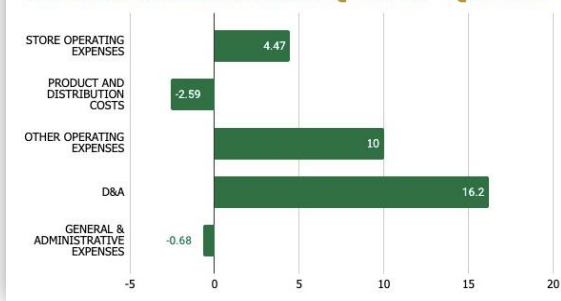
Figure 23
Source: Author

b) Other Operating Expenses:

1) **Marketing Experience:** 16.3% rise in Q1 FY24 due to post-pandemic marketing and customer engagement investments.

2) **Technology Upgrades:** Spending on tech for **better customer interaction and efficiency**.

3) **Supply Chain Management:** Investments in improving supply chain efficiency.

4) **R&D:** Higher R&D spending for innovation and new product development.

c) Depreciation and Amortization:

1) **Global Expansion & Renovations:** Capital expenditures for expansion and store renovations drive up depreciation costs.

2) **Inflation & Asset Values:** Inflation and **rising construction costs boost asset values**, leading to higher depreciation.

3) **Long-Term Leases:** Capitalized leasehold improvements from long-term leases contribute to increased D&A.
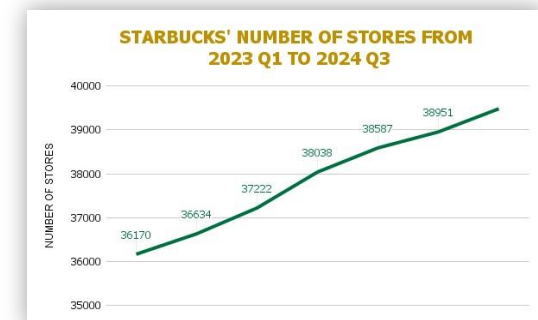
Figure 25
Source: CNBC

9. PR/ Marketing Failures

a) **Israel-Palestine Controversy**: Starbucks faced a lawsuit after a labour union supporting Palestine misrepresented its stance, leading to an **11% market value loss as shares dropped by 9%.**

b) **Racial Tensions**: In April 2023, a viral video showed **racial bias** when a black man was **denied bathroom access** at a California Starbucks, sparking outrage.

c) Starbucks has adopted a **product centric advertisement process**, straying away from their original unique selling proposition of having a **one-of-a-kind experience at Starbucks**.
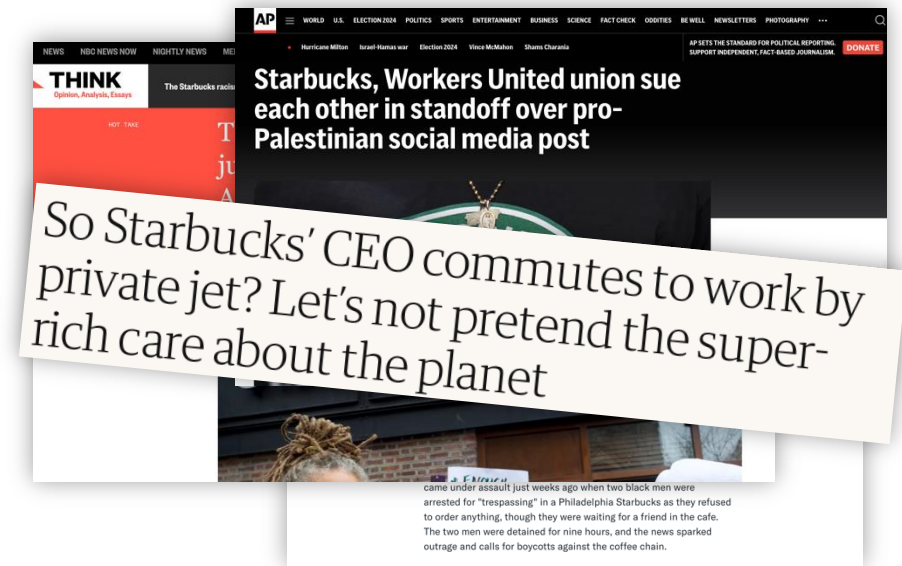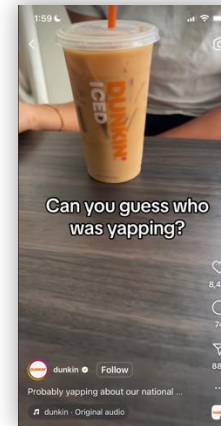
d) **Arpita Advertisement:** An advertisement featuring a trans model was a failed attempt at exclusivity, not reaching the target audience while simultaneously provoking the largely conservative Indian audience.

e) **Lack of trendy social media posts:** With many café's increasing their engagement on social media by using Gen-Z slang in their reels, Starbucks is slowly **losing resonation with younger audiences**.

f) **Starbucks CEO flying unreasonable distances:** The CEO of Starbucks chooses to fly over 1000 miles daily rather than relocation, being pointed out as **hypocritical as Starbucks has publicly** tried to improve environmental conditions by minimising plastic use.

Public Relations failures and lack of effective marketing, could have resulted in weaker consumer demand, leading to lower revenues and subsequently lower earnings.

Starbucks, Workers United union sue each other in standoff over pro-Palestinian social media post

So Starbucks' CEO commutes to work by private jet? Let's not pretend the super-rich care about the planet

came under assault just weeks ago when two black men were arrested for "trespassing" in a Philadelphia Starbucks as they refused to order anything, though they were waiting for a friend in the cafe. The two men were detained for nine hours, and the news sparked outrage and calls for boycotts against the coffee chain.
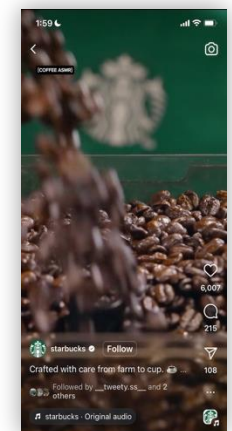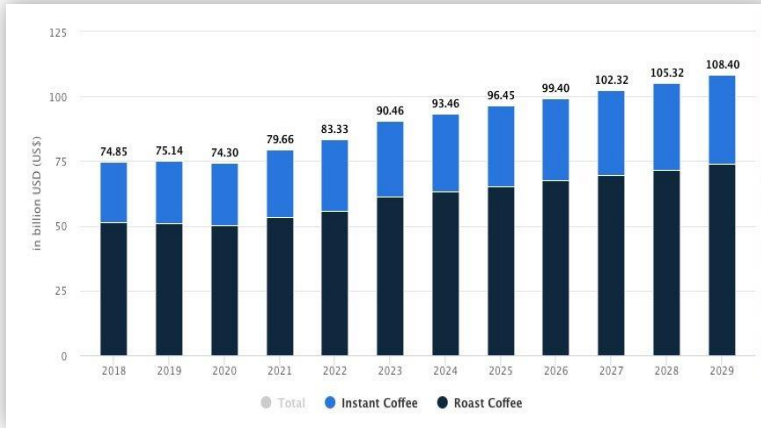
Dunkin'   Starbucks

V/S

10. Current Market Trends

Projected demand for at-home coffee

A survey we carried out with both Starbucks employees and customers

a) **Over 60% of consumers view private brands as equal or better than premium** options, gravitating towards cheaper options

b) Following Covid-19, Consumers are **increasing their demand for at home alternative** for coffee.

c) 47% of Gen Z feel pressured by unrealistic displays of wealth, leading to more thoughtful spending.

d) The **CAGR for energy drinks market in the past five years was 7.9%, whereas the CAGR for the coffee market as a whole was closer to 5%**, showing higher rates of increase in market size for the energy industry in relation to the coffee industry.

e) **Artisanal coffee is gaining popularity**, with consumers gravitating toward unique, handcrafted brews as part of the **wellness and experience trend**.

f) A survey that we carried out with International Starbucks customers heeded results, whereas the **loyal consumers switched to brands such as Dunkin' or Local Coffee chains due to immense hikes in prices**.

Current market trends have resulted in a changing perception of what prices people are willing to pay, and the types of coffee, and types of caffeine people enjoy consuming causing a decrease in demand for Starbucks.

One Year Turn Around Plan
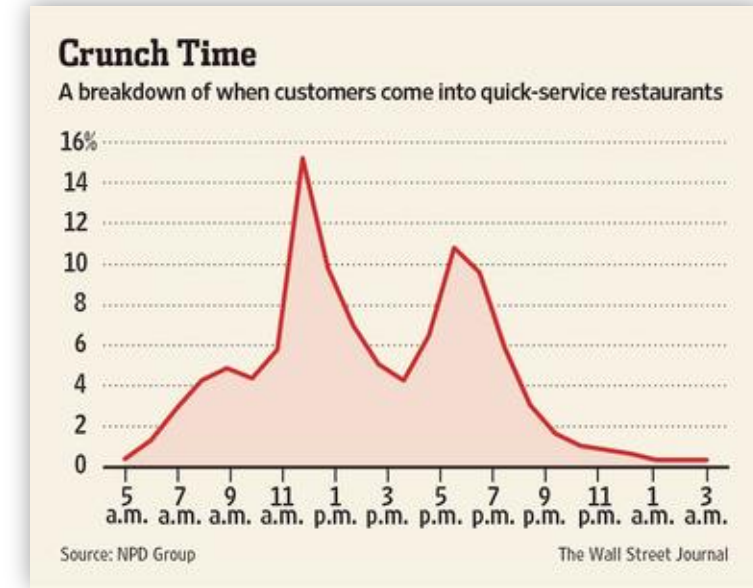
1. Increase consumer demand –

- **Sponsoring startups** – Hosting events similar-to Shark Tank, where entrepreneurs pitch to industry experts, within Starbucks. This would provide 2 key benefits

  - ➢ Creating an audience for such events that would directly contribute to an influx of consumers and revenue

  - ➢ Re-branding Starbucks as the ideal working environment attracting workers and business owners, for example, to work meetings etc. at Starbucks.

  - ➢ Attract an audience that typically has a higher propensity to spend, further being able to keep up with their super premium pricing strategy.

- **Advertisements, targeted on experiences**: Outlining experience rather than products allows consumers to better relate to an experience that they usually have at Starbucks, for example, students working on projects, rather than an objective colloquial approach to product advertising. **(Solution to point 9.C)**

- **Pushing Energy Drinks segments** - Starbucks should promote the advertisement of Starbucks' energy drinks in line with the current trends in the energy drink market, due to the 7.9% CAGR that the energy drink market is growing at. **(Solution to point 1)**

- **Product innovation based on Geography** – Collaborate with local with local cultural experts to formulate menu items that resonate with local audiences, winning over an audience that may have otherwise resorted to local café chains. Their current attempts to imitate local staples, such as in India trying to integrate Mango or Saffron flavors into drinks have been perceived as lackluster, often described as "cheap imitations". **(Solution to point 2)**

The advertisements need to be experience centric rather than product centric

2. Reducing Operating Expenses – *Operating expenses have increased by 5.5% since the last quarter of FY23, primarily due to an increase of Store Operating Expenses. This has happened while a mere 3.7% increase in number of stores, leading to a discrepancy between the increase of operating expenditure and number of stores.*

- **Employee Relocation** – Employees might be relocated to nearby stores **based on the busyness and the productivity** of their respective stores.

- **AR Training to onboard new employees** – **Augmented Reality can be used to onboard new employees**, rather than taking up human resources to manually train newcomers.

- **Flexible Employee hours** – Employees may only have to **work for 2-3 hours a day (during busy hours**), paid a higher per hour salary for a lower number of hours resulting in large scale savings in employee costs. **(Solution to point 8.a.1)**

Crunch Time
A breakdown of when customers come into quick-service restaurants

Source: NPD Group   The Wall Street Journal

3. Revenue Optimization:

Hedging - The usage of forward and swap contracts in countries where potential transactions are likely to take place especially in countries where they have recently established operations and where a bulk of sales is expected to occur. In countries like, China where there has been, for example, a 2.7% depreciation rate if Starbucks had implemented a forward contract a year ago the depreciation rate would not have affected the revenues reported from the country. This has already proven to work for companies like Toyota and GM. **(Solution to point 4)**

4. Alter Brand Perception:

Images like this on Starbucks walls can alter consumer perceptions

- **Local Marketing Teams –** Creating local marketing teams for all the nations and geographical areas fine-tune communication based on local requirements while also avoiding controversial issue

- **In the drive-thru, Starbucks can take a picture of the customer, starting a trend: "How funny is your image?"** like the popular "misspelled names" trend, to enhance the drive-thru experience and reinforce the brand.

- Add **testimonies and pictures of coffee bean farmers** where they are happy working to cultivate coffee beans, elevating the brand image of Starbucks and reassuring customers about their sustainable and ethical sourcing. **(Solution to point 9)**

5. Diversification of revenue streams:

- **Subscription model** – Allowing consumers to place an order for a product that they usually buy at a pre-determined frequency for better, quicker, and more efficient service as orders can be prepared before the consumer arrives, and he/she then only has to collect the order. This would increase the frequency of consumption while increasing brand loyalty due to repeat customers.

- **Increased emphasis on Merchandise with a new apparel line** – The growing sector in "Other" products including merchandise should be further backed due to their high profit margins through the creation of a new line of apparel. Furthermore, this may be able to attract a higher consumer base through creative slogans relating to coffee consumption (creating a better and more widely known brand image) and by having a Starbucks logo, for example, this could lead to organic advertisement. **(solution to point 1)**

Merchandise like this may be heavily sought out by customers.

Long Term Strategies

1. ***Operating Expenses can be reduced run for the long by:***

   1. **Franchises in China** – This would lead to a higher autonomy for Starbuck is stores, allowing them to incorporate local designs and tastes into their local market. Furthermore, using a franchise model, Starbucks can blunt the lower productivity seen in Chinese stores being about 50% as productive as stores across the rest of the world, as the franchises take on some of the opex burden. **(Solution to point 6)**

   2. **Close less Productive Stores** – Closing down the less productive stores would allow Starbucks to remove redundant resources and increase the revenue earned through newer stores which are better placed according to population, office and commercial densities. Furthermore, these newer stores like the **Wadakura Fountain Park store in Japan** tend to attract more customers than older stores. **(Solution to point 7)**

The 'get back to school' Starbucks program from 2016

Example of a recent acquisition in the coffee-world

2. *Increasing Consumer Demand in the Long Run:*

   1. **Strategy to have 2 channels**

      - **Traditional Starbucks** – Have the same traditional stores at the current premium price to attract similar consumers to what they're currently attracting. **This will be experience centric, with stellar architecture and store locations to give the sense of an upper premium establishment.**

      - **School Program** – Starbucks will reach out to various high-fees private schools and set up '**mini-Starbucks' with lower number of menu options, minimizing costs, allowing them to focus on volumes,** driving a growth in consumer base and overall revenue. This will allow Starbucks to target students at lower prices **without diluting the brand value of Starbucks**. **(Solution to point 10)**

   2. **Acquisitions/Mergers with local stores and regional chains** - Starbucks can merge with local coffee houses, especially in non-US markets which will help them achieve the integration of local coffee trends through the re-branding of these coffee house products as Starbucks products to win over customers loyal to these local cafes, and reduce the capital required to open-up a new store. **(Solution to point 7, 9 and 10)**

Implement Artificial Intelligence in Stores

- As seen in Figure 26 we can see how there is an increase in trend of customers who say that wait time is longer. For this we have a solution of **implementing an AI screen at the point of sale integrated with a camera for facial recognition**. This will have two key features:

    1. By matching the face with its database, It would help a new customer place orders and help existing customers order their usual with their customizations.

    2. Moreover, like NIH stated that **AI can understand the level of tiredness by a person's face**, it can be used to give a recommendation to the customer on the amount of caffeine they need in their coffee, making the experience more personalized and improved. **(Solution to points 8, 9, and 10)**

    3. Despite high capital expenditure in the short run, this will be a new twist to the coffee market, reducing order time, and driving more customers who are curious about this technology to Starbucks.

Figure 26
Source:
CNBC

CUSTOMERS WHO SAY WAIT TIME IS LONGER

- Increasing emphasis on **expansion in geographical locations outside of China and the USA**.

    1. Nearly 80% of revenue derived from the USA and China mean that Starbucks has a large proportion of consumers in a relatively small geographical segment.

    2. Emphasis on **other geographical segments such as India where the market for coffee is increasing at a CAGR of 9.87%** will lead to two main things:

        i. Decreased risk from factors such as trends and economic cycles due to a larger consumer base.

        ii. Overall higher revenue due to larger number of transactions.