

Starbucks – Premier Roaster, Marketer and Retailer of Specialty Coffee



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LEVEL 6 STRATEGIC MANAGEMENT

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1.0 Executive Summary

Starbucks was a café established in Seattle in 1971 selling coffee, dedicated to creating a warm and welcoming atmosphere, with the aim of sharing great coffee with friends and making the world a little better. Starbucks is now an international organisation, operating stores in 75 countries around the world, and generating an annual turnover of 21,315.9 million (US\$), as of June 2017.

Starbucks utilised the generic competitive strategy of differentiation. Starbucks is described as the innovative leader of the coffee industry with competitors regularly replicating their new products, processes and services.

A differentiation strategy has many benefits to an organisation, including:

- It is easily adaptable for each organisation, market or industry.
- It allows the organisation to demand a premium price for their product or service.
- It creates barriers to entry, minimising the number of new competitors to the organisation utilising the strategy.

Although there are great advantages of differentiation, there are also disadvantages, including:

- The need for constant innovation so the organisation can maintain their competitive advantage.
- The expense incurred through research and development to create new product and services.
- There are only a finite number of innovative ideas an organisation can introduce, especially in the food and drink industry. Therefore, the strategy may be unsustainable long term for organisations such as Starbucks.

Starbucks is clearly successful in utilising a differentiation strategy which is illustrated in their continuing growth in annual revenue, so it would be recommended that the differentiation strategy is used by Starbucks, in the short term. In the long term, Starbucks should consider utilising a cost focused strategy when the differentiation strategy becomes unsustainable. Using the cost focused strategy, Starbucks can focus on a particular area of the market, such as luxury coffee, and take advantage of their experience, brand power and economies of scale to reduce costs.

2.0 Introduction

2.1 Purpose of the Report

This report will identify the competitive strategy Starbucks utilises and evaluate how that competitive strategy has developed their competitive position. Recommendations will be made for appropriate steps the organisation can take in the future.

2.2 Starbucks' Background

Starbucks was established in Seattle in 1971, with the aim of sharing great coffee with friends and making the world a little better (Starbucks, 2017a). Since then, the organisation has expanded their product range from simply hot coffee to iced beverages, teas, food such as pastries and sandwiches, and products to take home including travel mugs and coffee beans (MarketLine, 2017). The company now operates in 75 countries internationally, with approximately 254,000 employees and an annual turnover of 21,315.9 million (US\$), as of June 2017.

Starbucks has been described as implementing an aggressive expansion strategy (Trefis Team, 2013). As demonstrated below in table 1, Starbucks has expanded rapidly since 2012.

Fiscal Year	Number of Stores Internationally at Year End	Increase in Number of Stores (%)	Net Revenue (US\$, millions)	Increase in Revenue (%)
2012	18,066		13,276.8	
2013	19,767	9.4	14,866.8	12.0
2014	21,366	8.1	16,447.8	10.7
2015	23,043	7.9	19,162.7	16.5
2016	25,085	8.9	21,315.9	11.2

Table 1 – Starbucks' Store Number and Revenue Growth. Derived using data from Starbucks Corporation (2013), Starbucks Corporation (2014), Starbucks Corporation (2015) and Starbucks Corporation (2016).

Starbucks has grown steadily over the last 5 years, with the percentage of new stores being opened varying between 7% and 10%. Starbucks' revenue has also grown greatly, increasing by 10% to 17% per annum. The larger increase in revenue compared to store openings show that not only are Starbucks' new stores generating new business, but existing stores are also generating increased revenues each year.

2.3 Definitions

2.3.1 Strategy

A plan which outlines the steps an organisation will take to reach the objectives and long-term goals of the business (Morrison, 2006). This could be for the organisation to be the consumer favourite in their particular industry, which may be achieved by improving the quality of their product or by reducing costs and being the cheapest options available for consumers. Alternatively, the organisation may want to generate higher profits than previous years which may be achieved by implementing a new marketing strategy and investing in promoting the organisation or product.

2.3.2 Business Level Strategy

“How an individual business competes in its particular market” (Johnson et al, 2014, p.759). This may include the strategy used by a branch of a parent organisation. For example, Mars Incorporated would use different business level strategies for the confectionary brands compared to their pet food brands.

2.3.3 Corporate Level Strategy

“The overall scope of an organisation and how value is added to the constituent business of the organisation as a whole” (Johnson et al, 2014, p.759). This would include Mars Incorporated’s overall strategy which would be used company wide.

2.3.4 Competitive Advantage

“A strategy that strongly positions a company against competitors and gives that company the strongest possible strategic advantage” (Law, 2016, p.130). Magretta (2011) states this is achieved by operating at the lowest cost, commanding a premium price or both.

2.4 Porter's Generic Strategies

Porter (1980) states there are three generic strategies an organisation may utilise to generate a competitive advantage; cost leadership, differentiation and focus. Anything which falls outside of these three are referred to as 'stuck in the middle' strategies.

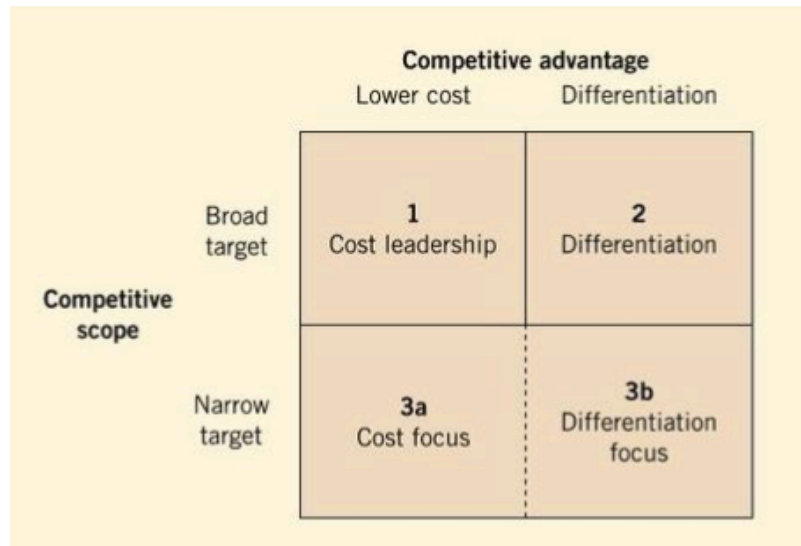


Figure 1: Porter's Generic Strategies Diagram (Johnson et al, 2014).

2.4.1 Cost Leadership

Johnson et al (2012) explains that the cost leadership approach involves the organisation becoming the lowest cost in their particular market; not the lowest price to consumers. This can be achieved by using one of the four key cost drivers; input costs, economies of scale, experience and product (or process) design. Input costs include the cost of raw materials and labour. An organisation may reduce their input costs by sourcing their raw materials from countries where the cost is far less than closer to home, or by outsourcing their operations to countries where labour costs are lower. Economies of scale is when an organisation increases the volume of output units which in turn decreases the cost of production. Experience can also decrease costs; as an organisation becomes more experienced, they become more efficient, and therefore the time-saving creates lower costs. Finally, product or process design can help an organisation decrease costs as the cheapest materials can be used for a product design, or a cheaper alternative for their processes can be used; for example, a clothing store may decide to exclusively sell their products online rather than having a costly store front. Cost leadership will only act as a successful strategy for one organisation within a market or industry. This generates intense competition between organisations, with each organisation forcing prices down to compete, and possibly creating a price war within that industry. Cost leadership can also cause an organisation to fall behind others in the industry, for instance, if they are not investing in up-to-date technology which consumers would expect from the organisation. Therefore, although they may still be the cost leader, they may lose customers and will not generate the same profits as competitors which have invested in innovative technology or processes.

2.4.2 Differentiation

Porter (1980) defines differentiation as “creating something that is perceived industrywide as being unique”. Differentiation should give the customer a reason to go to that organisation and not their competitors (Hooley et al, 2012). This could be by having a product which cannot be found elsewhere, or offering a service which surpasses competitors. For example, the online store Etsy bases their whole business model on selling “unique and creative” gifts which cannot be found anywhere else in the market (Etsy Inc., 2017). Apple (2017) pride themselves on bring innovative and differentiate themselves from other technology companies by having a distinct product design from their competitors and using a unique operating system which is not compatible with non-Apple devices.

2.4.3 Focus

Porter (1980) states focus can take a variety of forms, but is based on serving a particular niche or gap in the market. The two main forms focus strategies take are highlighted on Figure 1; cost focus and differentiation focus. Johnson et al (2012) use the example of Iceland Foods as a cost focused organisation. They use a cost leadership strategy, but they also specialise in frozen foods which differs from their competitors, such as Asda, which sell a wider range of food products. Law (2016) states a differentiation focused organisation seeks to differentiate themselves from their competitors in a defined sector. For example, Rolex (2013) pride themselves on being the “pioneer of the wristwatch”, providing excellence and perfection in every product. However, this is within the high-end, luxury wristwatch segment, and not in the watch industry as a whole.

2.4.4 ‘Stuck in the Middle’ Strategies

Porter (1980) declares that stuck in the middle strategies are almost destined to fail, and if they do succeed, they will have low profitability. Porter explains that if an organisation does not utilise one of the above strategies outlined in 2.4, then it will fail as they would be offering the same product but at a higher cost than their competitors, and therefore they will have a smaller profit margin, or they will not attract customers as they cannot be distinguished from their competitors. Both of these result in a failing business, or a not very profitable one.

3.0 Main Findings

3.1 Starbucks' Implemented Strategy

Starbucks (2017b) demonstrate that they are not a basic coffee shop that simply want to sell coffee. Starbucks state their values are to create a warm welcoming environment for everyone, and that they are driven by humanity with the inspiration of making the world a better place, one cup of coffee at a time. Although hot coffee is the foundation of Starbucks, their vast array of products means their competitive strategy must be one which can be successful industrywide. Trefis Team (2016) describe Starbucks as the product innovators in the market, introducing new products such as dairy free drinks and the popular Pumpkin Spice Latte, which are often replicated by their competitors. In 2011, Starbucks introduced their instant coffee range in supermarket retailers in the UK, enabling consumers to have a taste of Starbucks at home. This was replicated by Starbucks' largest competitor, Costa Coffee, in 2012 (Marketline, 2013). Due to the innovative nature of Starbucks and its industrywide success, it appears Starbucks utilises the differentiation strategy.

3.2 Advantages of Differentiation

3.2.1 Adaptability and Creativity

Differentiation allows an organisation to be creative with how they will diversify themselves from their competitors, customising this strategy to suit the individual organisation. This could be achieved using alternative technologies, or offering a service or product which differs from others in the industry. Hooley et al (2012) state an organisation must recognise that customer tastes are continually changing. Due to the nature of Starbucks' products, it is relatively simple for them to adapt; creating new and diverse products. As stated above, Starbucks has already displayed that they are the innovative leader in their market, helping them to easily differentiate themselves from their competitors. Wang (2016) describes how Starbucks has redesigned tea-drinking in China. Recognising that the plain, traditional tea consumed in China was geared towards the older generation, Starbucks introduced flavourful, infused teas, marketed towards the younger generations in China. Combining this with the service and modern atmosphere Starbucks is globally known for, Starbucks instantly differentiated themselves from other cafes in China.

3.2.2 Premium Pricing

An organisation offering a unique service or product has the power to command a premium price from customers. The average price of a Starbucks latte is £2.60; according to fastfoodprice.co.uk (2017). Yet a branded instant coffee costs a fraction of that. For example, ASDA (2017) are selling Nescafe Gold Latte instant coffee sachets for £2.00 per 8 sachet box; therefore, a branded instant latte costs just 25 pence, 10 times less than a Starbucks latte. However, due to the quality of the products and the environment Starbucks offer, they are able to retain customers and convince them to spend that extra money on their products.

3.2.3 Brand Loyalty

A company which initially uses a differentiation strategy can initially attract consumers and generate a loyal customer base. When it was established in 1971, Starbucks was a one-of-a-kind coffee shop. Even when the company has not got a new product, the loyal customer base continues to buy from the company on a regular basis.

3.2.4 Barriers to Entry

Differentiation being utilised by already established organisations can create barriers to entry for any new-comers to the industry. Starbucks' quality of coffee and the equipment they use cannot be cheaply obtained by new organisations. This helps Starbucks as they will not have an influx of competitors which can produce the same products as them. Also, due to the large number of raw materials Starbucks purchases to cover all their stores internationally, they are likely to benefit from economies of scale, as discussed in 2.4.1. This means Starbucks are able to get their raw materials for a reduced price in comparison to smaller organisations which would not have as much bargaining power as an internationally successful business like Starbucks.

3.3 Disadvantages of Differentiation

3.3.1 Continuous Innovation Required

As demonstrated above in 3.1, although Starbucks is the innovative leader, their competitors are able to easily replicate their new ideas and creations. Therefore, to retain their competitive advantage using the strategy of differentiation, Starbucks must constantly keep adapting and developing to create new products and services to stay ahead of their competitors. Starbucks has attempted to reduce replication by trademarking the name of their new products and patenting the equipment and processes they use. For example, they have trademarked the name of their iced coffee and milk drink, the 'Frappuccino' (Intellectual Property Office, 2017a), and they have patented the apparatus used for carbonating their drinks (Intellectual Property Office, 2017b). However, this has not stopped rivals from producing similar drinks to Starbucks. For example, Costa Coffee (2017) have their equivalent of the Frappuccino called the 'frostino', which is available in similar flavours to Starbucks' Frappuccino.

3.3.2 Expense

Research and development (R&D) to create a new product, service or process is very costly to businesses. Centre for Industry and Government (2010) states the food and drink industry account for 4% of the total research and development spending in the UK. Considering the relatively low price of food and drink, compared to other industries which invest in R&D such as pharmaceuticals and technology, this 4% is a fairly substantial proportion. With Starbucks being the innovative leader in the coffee industry, they are likely to invest heavily in the creation of new products. As discussed in 3.3.1, these products are easily replicated, and competitors can wait to see if the product is successful in Starbucks before implementing it themselves. Therefore, Starbucks have the expense and risk of developing new products, but their competitors are able to utilise that and replicate the product at no expense.

3.4 Implications of Differentiation

3.4.1 Consumer Needs and Loss of Investment

Porter (1980) suggests that differentiation becomes more difficult overtime. When an organisation like Starbucks uses differentiation, their innovative ideas can be replicated relatively easily by competitors and constructing new products and ideas to differentiate the organisation can become difficult. With a reasonably simple product like coffee or food, there appears to be a finite number of innovative ideas an organisation can come up with which consumers actually want or need. A company may invest heavily in a new product or service, but if the consumer doesn't consider it a necessity or it isn't desired to the level the organisation predicted, the company will not make their investment back.

4.0 Conclusion and Recommendations

4.1 Conclusion

Starbucks appear to utilise the differentiation strategy successfully. With their annual revenue continually increasing and thousands of new stores opening globally each year, Starbucks are clearly prospering in the coffee industry. Although they are the innovative leader in the coffee industry, competitors have been able to replicate Starbucks' innovations resulting in the organisation needing to create new products and services to stay ahead in the industry, which incurs R&D costs. The disadvantages to Starbucks using the differentiation strategy hasn't prevented them from dominating the market, despite their competitors replicating their ideas and products.

4.2 Recommendations

Starbucks should continue utilising the differentiation strategy, in the short term at least. As illustrated in 2.2, Starbucks' revenue has continually grown over the last five years, indicating that their competitive strategy is working for the company and assisting the company's success.

Starbucks could be advised to heavily trademark and patent everything possible to prevent competitors replicating their products, services and processes. Starbucks already trademark and patent many aspects of the organisation, but most elements are still easily replicated.

Due to the risk of a differentiation strategy being unsustainable, Starbucks could consider utilising a cost focused strategy in the future. The company could focus on the luxury coffee market, reducing the number of competitors such as small, local coffee shops and lower price coffee selling chains such as McDonalds and Greggs. Starbucks can use their experience, brand power and economies of scale to reduce their costs, as discussed in 2.4. Utilising a cost focused strategy would eliminate the expense of R&D to Starbucks, which is currently essential for a differentiation strategy to have a competitive advantage over their competitors.

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