Starbucks Financial Performance Demand Pricing and Market Analysis

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Milestone Two

Section II

The overall trend in demand has been positive overall. Proof of this can be seen in Figure 1 in the appendix section, which has Starbucks' financial highlights. As you'll observe from Starbucks's net revenue, you'll notice that Starbucks had a growth of $1.1 Billion in 2017 (22.4 – 21.3) according to the accepted accounting principles, which is about a 5.2% increase (Starbucks, 2017). This shows a favorable position for Starbucks as it has observed continuous growth in net revenue over the past four years, as you'll observe from the figure. The growth of Starbucks is not a bad thing in the coffee beverage industry as there are still a high number of substitutes for it; furthermore, the coffee industry benefits from it as well; thus, it has more positive than negative impacts. The same can't be said about increasing prices, though. Starbucks consumers' buying habits stay the same even if the price is slightly increased. The growth in sales is due to some key factors, but most of it can be attributed to Starbucks's expansion plans in the Asia Pacific region as well as the launch of reserve stores in some high-growth markets (Trefis Team, 2016). Another key factor contributing to the growth in revenue is the innovative food options. More and more, people are trending towards healthier and fresher eating options. Starbucks has recognized this trend and, in turn, has introduced healthier and innovative food options (Trefis Team, 2016). Also, Starbucks is investing in Teavana, which has contributed one percentage point in comparable sales growth for seven consecutive quarters. This is a risky but calculated move by Starbucks as it is hoping that the popularity of Teavana will follow it from America to China, which is one of the largest tea-consuming countries in the world and will give the brand a boost (Trefis Team, 2016).

Section III

It's a well-known fact that Starbucks has never lowered the prices of its beverages; however, even if there is a slight increase in price, people are still not deterred from buying it. According to the Guardian, when they questioned a patron regarding the increase in price of Starbucks beverage, the patron laughed and said, "A few cents extra doesn't bother me," Most of Starbucks's customers don't

even pay any attention to the prices at all (Puglise, 2016). Thus, it can be observed that the customer responsiveness to the change in price was little to nothing, indicating that Starbucks has an inelastic demand-supply. Starbucks takes advantage of this and doesn't decrease the prices at all; instead, it raises prices even while the price of coffee beans, which are one of the main ingredients in almost all of its products, decreases (Sommer, 2015). Furthermore, Starbucks is not in the business of selling a commodity but rather selling an experience. The company's brand image has allowed it to raise prices without anyone batting an eye, and Starbucks knows this and takes advantage of it to create more revenue for itself (Sommer, 2015). Another thing Starbucks is known to do is pre-agree on coffee prices with its suppliers before the following year. In the current case, where the price of coffee dropped unexpectedly, Starbucks likely suffered and had to pay more as it probably already locked in the price of coffee with its suppliers and thus had to pay more. However, coffee only accounts for 10% of Starbucks's expenses as it has to pay more for the premium coffee experience they are providing regarding location, benefits to its employees, as well as distribution and marketing (Sommer, 2015).

Milestone Three

Section IV

Starbucks is a multinational coffee company and coffeehouse chain with branches all over the world. As a coffee company, Starbucks's main cost is its coffee beans. The two most commonly consumed coffee beans in the whole world are Arabica and Robusta, which Starbucks imports from various continents to ensure that supply keeps up with the demand. Arabica is less strong in flavor when compared to Robusta, which is more commonly used in Starbucks as it more easily blends in with the various flavors or beverages made by Starbucks (Krikorian, 2014).

Furthermore, Starbucks's huge size allows it to take advantage of economies of scale. The cost structure is pretty straightforward for Starbucks as it is similar to those typical of high-end, fast-casual restaurants. Starbucks has recently started buying back its shares to pay increased dividends to investors as well as use them to fund international expansion attempts. Furthermore, Starbucks's operating costs have been declining (please refer to Figure 1). The cost of goods sold has slowly been declining as well, thanks to a decrease in the price of coffee beans while the price of the products remains the same. Store operating expenses and depreciation costs have been decreasing in general, thanks to business growth and efficient cost management. Starbucks further acknowledges the fact that price volatility for its ingredients is a big factor that contributes to costs, which is why Starbucks has a derivative contract to reduce commodity price risks. These contracts are typically there for five years; however, it is important to remember that if the price of any of the ingredients, which are mainly sugar, milk, and coffee, falls, it'll put Starbucks at a loss as they'll be paying more when compared to the market price as they had already fixed a price with their suppliers (Krikorian, 2014) (Sommer, 2015).

Section V

Looking at Figure 2, which has figures from 2016, you can see that Starbucks holds the majority of the market, while Dunkin Donuts comes in 2nd at 21.9%. The rest of the coffee chains are negligible and are thus not listed separately but as a singular unit, which amounts to 38.3% (Statista, 2018). With that data alone, we can see that Starbucks is the leader in the market, and if you combine Dunkin Donuts and Starbucks, the combined percentage makes up more than 50% of the total market. Referring back to Figure 1, you can see that Starbucks has been experiencing a growth in profit for the past four years. Furthermore, Starbucks's operating income has also gone up, which means that its day-to-day expenses have gone down; this tells us that Starbucks is performing profitably. Other competitors are going to have a hard time entering the market regardless of whether they come up with something new or not. The reason here is quite simple. Starbucks's international exposure works in its favor, and people would prefer to buy from a brand that has a good reputation than one that is not yet known. Furthermore, due to economies of scale, Starbucks could just lower its prices during the initial phases when the new business starts operating and then increase them again once the other business closes down due to lack of business as they won't be able to compete in the same way. Being a large corporation, Starbucks can influence the market to a certain extent. By driving up its prices to a reasonable amount, Starbucks can influence the market and still make a profit due to an inelastic demand-supply. Furthermore, it can also make other businesses fail by reducing the price of its products to get people to buy them more and ultimately stop buying them from their competitors who can't compete due to the lack of capital as well as their small size.

Section VI

In my opinion, Starbucks is performing quite profitably, and there isn't much to do as they are already doing all the necessary things that they should be doing. Operating costs have been slowly going down, and profits are increasing as well. If anything needs to be said, it's the fact that Starbucks has done a good job on its own.

However, I would further recommend that Starbucks focus on the Asian markets, especially China. Being an enormous emerging market that is slowly allowing big businesses to open up shop in their country, Starbucks is doing well in gaining a foothold, although more could be done by focusing more of its capital and resources in that region. Furthermore, Starbucks's acquisition of Teavana was a very good move on its part as they correctly recognized the fact that the Asian regions prefer tea over coffee. All Starbucks needs to do now is to ensure that it keeps pumping its subsidiary company with cash and capital, as there is already other competition in these markets, such as Chatime and Tealive.

To further sustain its success, Starbucks needs to take advantage of the economies of scale it possesses to create an advantage for itself. Although this could be considered unethical, our job is to consider a way in which we can sustain our profits, and further, having an inelastic demand curve helps as the unethical practice will probably not affect buying power but could result in a monopoly in

which a government could intervene. All in all, Starbucks is doing well but can do SLIGHTLY better by focusing on these things while being patient at the same time.

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