

Economic Values of Starbucks

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ECON 2110

October 19th, 2023

Abstract

If you enjoy spending money, reading this paper is in your best interest. Economics is in every aspect of our lives; hence the importance of understanding the role of economics in society since even your favorite hobbies and interests revolve around money. For millions of people, coffee is a daily interest and, in some cases, a habit. Patronizing Starbucks each morning before work or school has become a routine for a majority of U.S. citizens, giving Starbucks the leading position in the coffee industry. Since Starbucks generates just as much revenue as major brands like Apple or Walmart, its economic factors should be analyzed in the same way. In this paper, a brief business history is given followed by supply and demand relations. Price elasticity for Starbucks and its importance are discussed as well as costs of production. An examination for the overall market of the coffee industry is also given, followed by a personal recommendation for how Starbucks should proceed in the future to continue their growth.

Introduction

The purpose of this paper is to study the microeconomic trends of Starbucks Corporation. Starbucks has become a household name not only in the United States, but globally. The business is known for its well liked coffee and other coffeehouse products. In this paper, an overview of Starbucks Corporation's history is provided followed by the supply and demand trends for the company. Price elasticity and cost of production are also analyzed with depictions of observed trends illustrated through charts and graphs. Lastly the overall market for Starbucks is given by studying the overall market for retail coffee stores and the barriers they faced to enter and how they overcome those challenges to succeed in the coffee market. While Starbucks is already flourishing, the final section of this case study involves recommendations for Starbucks Corporation to prolong their success in the future.

History of Starbucks Corporation

Starbucks began its story in 1971, when Starbucks founders Jerry Baldwin, Gordon Bowker and Zev Siegl opened its first store near Pike Place Market in Seattle, Washington. It was not until 1982, however, when Howard Shultz joined Starbucks as a Director of Retail Operations and Marketing introduced the next chapter of Starbucks in 1983 after a trip to Milan, Italy where he first experienced Italy's coffeehouses. He returned with this newfound influence and goal of exposing Americans to a new experience for ordering and enjoying coffee. The Starbucks' coffeehouse experience became more of a reality in 1987 with the first official Starbucks' lattes being served by employees in green aprons instead of the original brown aprons. The change proved successful with Starbucks opening locations in Chicago, Illinois and Vancouver, Canada before opening new stores in Washington D.C and New York. Starbucks then

went international with the opening of coffeehouses in Japan in 1996, Europe in 1998 and China in 1999. Starbucks has served millions of customers over the last 20 years and truly become a global brand. Despite its success, Starbucks continues to be dedicated to its original Mission: “To inspire and nurture the human spirit - one person, one cup and one neighborhood at a time” (Schultz, 2018) . It then evolved into Starbucks growing their own coffee beans and quickly gaining attention from many local investors. In 1990, Starbucks released another mission statement: “To establish Starbucks as the premier purveyor of the finest coffee in the world while maintaining our uncompromising principles as we grow” (Schultz, 2018). This set the foundation for how influential Starbucks would become in the near future.

By the year 2000, Starbucks had over 3,500 stores in more than eight different countries. Starbucks became one of the first coffeehouse franchises to offer free unlimited wifi for customers; this helped them gain popularity through social media outlets. In 2006, Starbucks launched the industry's first paper beverage cup containing post-consumer recycled fiber. (*Starbucks and International Paper Demonstrate Viability of Recycling Used Cups Into New Cups*, 2010). Starbucks has taken strong initiative to promote sustainability and eco-friendly products for their consumers. These standards are upheld to this day. Starbucks has become a household name for its sustainability efforts and its high quality coffee beverages while also offering a wide variety of coffees, teas, smoothies, juices, pastries, and other snack-type foods. They even have a large market for consumer goods such as individually wrapped coffee grounds, stainless steel cups, and kits to make popular drinks from home.

Supply And Demand Factors

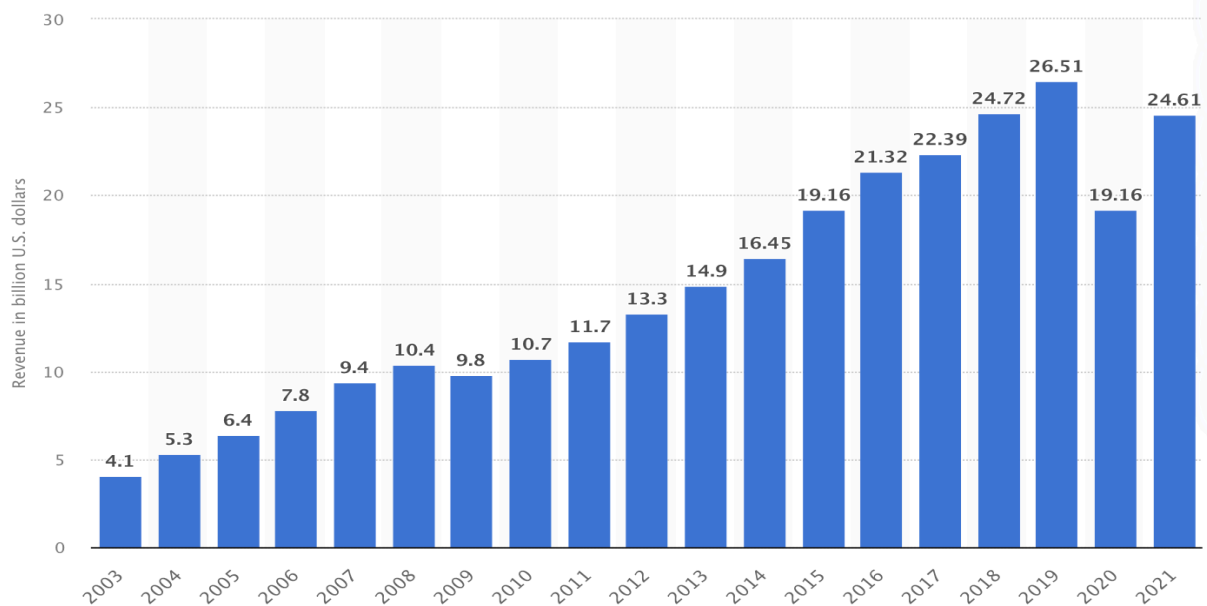
It is safe to say that Starbucks has revolutionized the industry of chain coffee houses both economically and socially. Starbucks is predicted only to further grow and flourish in the years to come. To understand the market demand of a company, it is important to look into who their customers are. Erica D'Arcangelo, CEO of Web Content Development Services, describes Starbucks audience as "...The percentage of the general public who can afford their higher priced cups of coffee on a regular or daily basis" (*The Starbucks Marketing Model Blog*, 2019). Starbucks has a clean and modern branding style; attracting an audience who is willing to pay for higher priced coffee.

Speaking of branding style, it is important to understand a company's market demand determinants. As Starbucks is categorized as a coffeehouse franchise, there are several determinants of its market with taste being the most important. Over the years Starbucks has worked on perfecting their menu to satisfy the overall tastes of current and potential new customers. This element is important because it determines if customers will continue patronizing Starbucks or switch to other coffeehouse competitors for their favorite tasting drink. Secondly, advertising plays an immense role in the market demand. The way a company portrays itself introduces the company's values and the company as a whole. Starbucks mostly uses social media platforms and their app to entice customers into their stores. The app is beneficial because it sends daily notifications to users grabbing their attention and keeping the brand in front of customers at all times. Starbucks also has a points rewards system through the app; encouraging customer rewards for patronage. Next, location is a major factor of market demand. Starbucks has easily accessible locations throughout the world. The inside of the buildings have a cozy and overall feel-good vibe and this atmosphere attracts customers to come inside, stay for a while and

chat with friends, study, read a book, or practically do anything they would like. Starbucks also has fast moving drive-thru lines which are convenient for customers who do not want to come inside or are in a hurry.

Annual Sales

Starbucks had annual sales of \$24.61 billion U.S. dollars in the year 2021, depicting an increase over the previous year's total of \$19.61 billion dollars. (*Starbucks Revenue Worldwide 2019, 2021*). The graph below from Statista shows the net revenue of Starbucks worldwide from 2003 to 2021 in billions of U.S. dollars.



The demand has a distinct increase, excluding the year 2020 due to the COVID-19 pandemic, which was detrimental to the demand of most businesses. In the following year of 2021, sales went back to nearly predicted growth. This graph predicts an increasing trend in the sales and demand of Starbucks. After examining demand, it is also important to look at supply. The second

participant of a market is the supply and its factors. Some factors include input costs, number of firms in the market, and technological improvements.

Starting with technological improvements, this affects how Starbucks produces its goods and services. As technology advances, it typically allows companies to lower the cost of goods produced. As the cost of goods and services decrease, companies are more likely to produce more products for lower prices; shifting the supply curve rightward. An example of this is in 2019 when Starbucks incorporated Microsoft into their work environment. As a coffeehouse, Starbucks relies heavily on its equipment like coffee machines, grinders, and blenders. Any mishap or glitch could mean serious repair costs and loss of revenue while waiting for the machine to be fixed. Furthermore, it can also take away from Starbucks's primary goal of providing a high quality product and fast, reliable customer service.

Microsoft created a network for Starbucks to securely connect all their devices, and to ensure security across all store equipment which is called Azure Sphere. This device sends new coffee recipes directly to all machines, which used to be done by email or thumbdrive. Jeff Wile, senior vice president for Starbucks Technology, states, "Think about the complexity — we have to get to 30,000 stores in nearly 80 markets to update those recipes, that recipe push is a huge part of the cost savings and the justification for doing this" (*Starbucks Partners With Microsoft to Enhance Personalisation and Efficiency*, 2019). This device also works to gather data to proactively identify problems to avoid delays. Moreover, Azure Sphere is able to count and manage inventory and supplies. All of these tasks are things which can cause delays as much as reactive maintenance. Reducing these delays ensures more time for workers to spend with customers and saves money and materials in the long run.

Price Elasticity of Demand

Price elasticity of demand is arguably one of the most important aspects of comprehending how the economy of companies works. It is measured by calculating the change in quantity purchased of a product in regards to a change in its price. In order to take a deeper look into how this is determined requires looking into a few specific criteria. As of March 2022, the price range of products fluctuates from \$1.85 for a tall dark coffee up to \$5.94 for a pumpkin spice frappuccino. Since Starbucks is not a necessity and buyers do not have to buy products regardless of price, the demand is considered price elastic. This means when prices increase, consumers are very wary of these increases and may choose to do business elsewhere. Starbucks coffee is considered a luxury good. If prices rise, demand will decrease. One specific example of this occurred in 1994. A major frost hit a Brazilian coffee crop in 1994, this caused a leftward shift of the coffee supply. This eventually led to a 10% increase in the price of coffee; but also led to the decline of 3% in the quantity of coffee consumed. (*What Is Price Elasticity of Demand for Starbucks Coffee?*, 2020).

Factors of Starbucks Prices

There are several factors that affect consumers' responsiveness to price changes. A few of these considerations are availability of substitutes, luxury versus necessity, and the passage of time. As stated earlier, Starbucks is considered a luxury over a necessity. Similar to a vacation or having a pet, buying coffee at Starbucks is enjoyable, but not a necessity. There are countless competitors who act as substitutes for Starbucks. Dunkin Donuts, founded in 1950, is Starbucks' biggest competitor. Dunkin Donuts is significantly less expensive. For example, a large latte at Dunkin Donuts costs around \$2.49. The same drink at Starbucks costs \$4.15, nearly a two dollar

difference. If Starbucks is too expensive for consumers, other competitors are cheaper with the cheapest substitute being coffee brewed at home by the consumer.

Lastly, the passage of time correlates to elasticity of demand. The longer the period of time, the higher the price elasticity of demand. This point is due to the fact consumers get adjusted to change in prices or new prices over a period of time. When Starbucks first introduced higher prices, consumers were most likely not in favor of paying more for coffee but, as time passed, consumers eventually started buying Starbucks' products more often.

Elasticity and Revenue



















Lastly, it's important to assess the relationship between elasticity and revenue. Even though Starbucks already has a higher price point for their coffees, the company can still increase their prices if needed. Increased prices do not, however, necessarily mean consumers will purchase their coffee or other products which has to do with the elasticity of demand for Starbucks. Since Starbucks has countless competitors, consumers may purchase their coffee and products elsewhere if prices increase. Taking a look into Starbucks' latest price increase helps us understand this concept. Kevin Johnson, president and chief executive of Starbucks, explains the reasoning for an eight percent increase in their prices. He states, "Although demand was strong this year, this pandemic has not been linear. The company has experienced higher-than-expected inflationary pressures" (Marcos, 2022). Johnson adds, "We have additional pricing actions planned through the balance of this year, which play an important role to mitigate cost pressures including inflation." Businesses worldwide are experiencing extreme inflation and most are still trying to economically recover from the COVID-19 pandemic. Since Starbucks has an elastic demand, the company is aware that increasing prices will deter consumers from purchasing their

products. It is necessary to understand the concept of elasticity of demand because it gives insight on how companies make financial decisions.

Costs of Production

The costs of being a leading competitor in your industry still does not dismiss a company from the several demanding costs of production. For Starbucks, its high end values come with high end prices daily. Starbucks relies heavily on the message of quality consumerism which comes with a cost. Starbucks spends \$600 million U.S. dollars per year on coffee products, and \$2.5 billion U.S. dollars on other products. These other products include baked goods, paper goods, furniture, and more. While Starbucks total value is much higher than those statistics, it still has an impact on the company's total profitability. Taking a look at the income statement from 2021, the cost of goods sold, which is highlighted, was \$22,462 million U.S. dollars for 2021. This price accounts for the costs associated with the manufacturing of their sold products .

For the second section highlighted, expenses, the cost was \$1,993 million U.S. dollars. This includes costs beyond raw materials, such as rent or insurance. Comparing the year 2021 to 2020, costs of goods sold decreased by more than \$2 million U.S. dollars. For expenses, the statistics also decreased by around \$200,000 U.S. dollars. When these values increase, it can mean prices have risen. So from 2020 to 2021, Starbucks also raised their prices for goods.

Fiscal year is October-September. All values USD Millions.						5-year trend
	2021	2020	2019	2018	2017	
Sales/Revenue	29,059	23,513	26,502	24,720	22,384	
Sales Growth	23.59%	-11.28%	7.21%	10.44%	-	
Cost of Goods Sold (COGS) incl. D&A	22,462	20,316	20,773	19,105	17,039	
COGS excluding D&A	19,689	17,616	19,324	17,799	15,972	
Depreciation & Amortization Expense	2,773	2,701	1,449	1,306	1,067	
Depreciation	2,549	2,477	1,217	1,119	1,010	
Amortization of Intangibles	223	224	233	187	58	
COGS Growth	10.56%	-2.20%	8.73%	12.12%	-	
Gross Income	6,597	3,196	5,729	5,615	5,345	
Gross Income Growth	106.40%	-44.21%	2.02%	5.06%	-	
Gross Profit Margin	22.70%	-	-	-	-	
SG&A Expense	1,933	1,680	1,824	1,755	1,393	
Other SG&A	1,933	1,680	1,824	1,755	1,393	
SGA Growth	15.06%	-7.92%	3.91%	25.99%	-	
EBIT	4,665	1,517	3,905	3,860	3,951	
Unusual Expense	147	282	148	(1,070)	159	
Non Operating Income/Expense	880	15	619	464	104	
Non-Operating Interest Income	71	50	132	260	127	

Variable And Fixed Costs

There are two categories of costs; variable and fixed costs. Variable costs change with volume such as labor, commissions, and raw materials. Fixed costs remain constant. Examples of this are leases, interest payments, and insurance. Both fixed and variable costs have a large impact on profit. An increase in expenses to produce goods means lower profit. Looking at the cost of goods sold gives us information about variable costs, and fixed costs will show up in operating expenses. Variable costs for Starbucks include labor, coffee beans, dairy, and plastic products. Fixed costs for Starbucks include advertising, app software, rent, taxes, and insurance. Starbucks tends to have higher marginal numbers in costs of goods sold and variable costs.

Suzanne Kvilhaug, researcher from Bridgewater University, says this is because profits are severely impacted by things such as inflation of price of coffee beans (*Coffee Shop Market Value in US*, 2021).

Overall Market

Looking into a company's income report has many economic benefits. One of those benefits is it allows you to analyze the overall market. This does not mean the stock market; whatever product a company produces determines its market. For Starbucks, the overall market is chain coffee shops. Based on data from Statista's online database, the market for coffeehouses in the United States reached a value of \$47.5 billion U.S. dollars in the year 2020. (*Coffee Shop Market Value in US*, 2021). Of that amount, Starbucks held the highest percentage at 40%. Following that, Dunkin Donuts had approximately nine thousand stores holding a market percentage at 27%.

Barriers to entry are an important factor to understand the overall market. Barriers to entry describe factors that could prevent new companies into a market. Some common examples, including startup costs, capital requirements, or brand loyalty can either help or hinder a company. Looking at the market for coffee houses, there are various barriers to entry. For companies that are just starting out, it is intimidating to be compared to Starbucks, a company who dominates its market thanks to a loyal customer base who consume Starbucks products not just multiple times per week but sometimes multiple times daily. While a huge customer base is great for Starbucks, it is a huge barrier to entry for newcomers desiring entry into a now huge coffeehouse market. So having a huge base of loyal customers benefits Starbucks and gives them a sense of protection. Another barrier specific to the coffee industry is technology. For a

company just starting out, it's likely they do not have the funds to produce a high functioning app to support them. Starbucks, on the contrary, receives 31.7 percent of their orders through the mobile app (*Mobile App Use of Starbucks Consumers US 2019*, 2021). The Starbucks app is also useful for receiving promotions, product information as well as calorie and nutritional information. All of these barriers make it difficult for other companies to break in and succeed in this type of market.

Next, the structure of a market is a great factor to include when studying a company. The coffee shop industry is a monopolistically competitive market which means there are several large companies competing but each company has their own marketing power. They can choose and differentiate their own prices. As supported earlier, Starbucks is the leader of its market and has a substantial position within it. Starbucks also maintains a strong influence on its market. Their advantage is for many reasons; two of which include their product differentiation and strategy differentiation.

Over time, Starbucks developed and implemented a concept called the third place environment. Starbucks CEO, Kevin Johnson, describes the concept as, “ a mindset — a feeling of comfort that uplifts customers everywhere, and in every way, they experience Starbucks” (*Starbucks Ceo: The Third Place, Needed Now More Than Ever Before*, 2020) . The third place environment strives to provide a safe, comfortable, and familiar experience for consumers; ultimately bringing them back time and time again. The concept revolutionized the idea of a coffee house with Starbuck’s realizing its dream as the leader of the coffee house market.

Recommendation

While Starbucks is a globally recognized company, there is always room for improvements and recommendations to continue their success. Starbucks has revolutionized the way coffee houses advertise their products. I recommend the continuation of the Starbucks app. Most customers, including myself, use the starbucks app on a daily basis. To increase productivity, Starbucks should introduce a delivery service through the app. Some Starbucks locations currently use Uber Eats and Doordash, but I suggest Starbucks using their own company for deliveries. This will make the app even more versatile while increasing revenue. Consumers using the app to have their purchases delivered will ultimately allow the Starbucks' app to be a one-stop shop instead of making consumers use secondary apps. It will also increase productivity of the app. Lastly, making an easy, customer friendly way to get Starbucks delivered at your doorstep will improve their popularity in the market. In addition to drinks, it also includes products like cups, mugs, coffee and tea bags so customers will be able to order their favorite mugs or other products from home and have them easily delivered. The costs of this delivery service would include jobs and an opportunity to hire new employees to hand deliver these products. Other expenses to be considered with this recommendation would include gas money and updates to the app software.

As concluded through my research, Starbucks is the leader in its overall market. Implementing changes would have an effect on their other competitors and the market as a whole. Since Starbucks is so influential to others in the market, I believe this recommendation would be a success and result in other companies following them. If Dunkin Donuts would have initiated this before Starbucks, the outcome would not be as clear. Starbucks domination allows them to make changes like this one to their production. Secondly, there are recommendations for how Starbucks can strengthen their values. Compared to their competitors, Starbucks is not as

involved with social media. Dunkin Donuts, on the other hand, is constantly on TikTok and Youtube. They have paid partnerships with celebrities who advertise their drinks and products. Since social media is so influential these days, I recommend Starbucks increase their advertising budget and implement paid partnerships with social media influencers on social media platforms which will increase brand awareness.

Lastly, it is important for Starbucks to sustain their success from a profitability standpoint. With all of the changes I recommended comes increased prices for those things. Looking at trends in demand and price elasticity suggests that if Starbucks increases their prices it may deter customers. In order for the company to stay profitable and competitive, I recommend Starbucks not increase their prices at first. If the increased advertising through social media and updates in the app are a success and cause more overall revenue, then prices can be increased due to the increased value of the new services. It would be worthwhile to do market research by gathering data through trials testing how consumers react to these new changes in select markets. If sales are increasing due to these new changes being implemented, the company can afford to increase prices nationwide slowly. All of my recommendations are only to improve Starbucks, an already successful company who is the market leader in its business segment. After analyzing Starbucks through an economic lens, it made me realize how influential microeconomic factors are to the entire world. While Starbucks is a major company, it is only a fraction of the total economy for the nation. Analyzing a company like this helped me better understand the importance of all aspects of the economy and turned it into grasping society as a whole better.

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