Company Case 6

STARBUCKS: JUST WHO IS THE STARBUCKS CUSTOMER?

By now, you might be familiar with the Starbucks story. After a trip to Italy in the early 1980s, Howard Schultz was inspired to transform Starbucks—then just a handful of coffee shops in Seattle—into a chain of European-style coffeehouses. His vision was based not just on selling gourmet coffees, espressos, and lattes. He wanted to provide customers with what he called a "third place"—a place away from home and away from work. As CEO of Starbucks, Schultz developed what became known as *The Starbucks Experience*, built around great coffee, personal service, and an inviting ambiance.

What Goes Up . . .

It wasn't long before Starbucks became a household word; a powerhouse premium brand in a category that previously consisted of only cheaper commodity products. In about 20 years time, Schultz grew the company to almost 17,000 stores in dozens of countries. At one point, Starbucks opened over 3,300 coffee bars in a single year—an average of nine new stores every day. Starbucks stores popped up everywhere. In one stretch of crowded Manhattan, a person can get their caffeine fix at any of five Starbucks outlets in less than a block-and-a-half. In fact, cramming so many stores so close together caused one satirical publication to run this headline: "A New Starbucks Opens in the Restroom of Existing Starbucks."

For many years, growth was the engine that kept Starbucks percolating. As it grew, company sales and profits rose like steam off a mug of hot java. Growth routinely averaged 20 percent or more each year. And Starbucks made investors happy with a 25 percent annual increase in the value of its stock for more than a decade. Schultz confidently predicted that there was no end in sight for the Starbucks boom. Just a few years ago, he announced his intentions to open 10,000 new stores in just four years, and then push Starbucks on to 40,000 stores.

But not long after Schultz shocked Wall Street and the industry with his projections, Starbucks' steam engine of growth started to slow. Then, it started running in reverse. By the end of 2008, 20 percent annual growth had dropped to 10 percent, with existing-store sales *falling* by 3 percent. Total company profits dropped by a scalding 53 percent for the year. And for a second year in a row, Starbucks' stock value dropped by 50 percent to around $10 a share.

A weakened economy certainly played a role. But for years, many industry observers had worried that the company was growing too fast. Revenue and traffic at Starbucks began slowing more a year before anyone uttered the word "recession." In a sign of recognizing a problem, Schultz cut back on the number of new store openings. But then, he did what had previously seemed unthinkable. In 2008, he announced store closures—first 600, then 300 more. In fact, as Starbucks trimmed its 2009 forecast for new store openings to 310, it projected a *decrease* in its number of outlets for the first time ever.

The Evolution of the Starbucks Customer

There was no shortage of armchair CEOs, willing to give their opinions as to what had gone wrong that led to Starbucks' fall from perpetual growth. One issue often mentioned was that Starbucks had developed an identity crisis with respect to its target customer. In the early years, the Starbucks' customer profile was clearly defined. The typical customer was wealthier, better educated, and more professional than the average American. The customer was far more likely to be female than male, predominately Caucasian, and between the ages of 24 and 44. It was this customer who fell in love with the *Starbucks Experience*. She was very loyal, often visiting a store every day or even more than once a day. She loved the fact that the barista greeted her by name when she came in and chatted with her while making her custom coffee drink, not caring if it took a while. She lounged on the coffee bar's comfy furniture, enjoying the perfect mix of music that always seemed to fit her mood. She met friends, or just hung out by herself reading a good book.

But the more Starbucks grew, the more *The Starbucks Experience* began to change. With more stores found in closer locations, the place wasn't quite so special. As each location filled with more customers, baristas had more names to put with faces. As the menu expanded with more options, the number of combinations for coffee drinks grew in to the hundreds, leaving baristas less time to chat with customers. As the atmosphere in each store turned to "hustle and bustle," it became a less attractive place to hang out.

With all these changes, Starbucks progressively appealed less to the traditional customer and more to a new customer. This customer shift was inevitable—there simply were not enough traditional customers around to fuel the kind of growth that Schultz sought. The new breed of customer was less affluent, less educated, and less professional. Not only was Starbucks drawing in different customers in places where stores already existed, but it was also putting stores in different neighborhoods, cities, and countries.

As the customer profile evolved, *The Starbucks Experience* grew to mean something different. To the new breed of customer, it meant good coffee on the run. It was a place to meet, then move on. The more accessible the Starbucks was, the better. Speed of service was more important than a barista who wanted to talk current events. This new customer came in much less frequently than the traditional customer, as seldom as once a month. As a sign of just how much this shift in customer was affecting its business, by 2007, 80 percent of all Starbucks coffee purchased was consumed outside the store.

Soul Searching

When Starbucks' growth first started tapering off executives took notice. In a now famous memo to management, Schultz lamented that "in order to achieve the growth, development, and scale necessary to go from less than 1,000 stores to 15,000 stores and beyond, [Starbucks had made decisions that may] have led to the watering down of the Starbucks experience. Stores no longer have the soul of the past and reflect a chain of stores vs. the warm feeling of a neighborhood store."

Starbucks management believed that efforts to recapture that soul would get the company back on track. It set out to appease both the traditional purists as well as the new-school folks. In one major effort, Starbucks tried to tap into consumer emotion with a series of promotions that centered on regional cultures of the world, each with its own specialty coffee drink, artisan merchandise, and in-store artwork reflecting that culture. Starbucks also attempted to improve store service by adding labor hours and time-saving automated machines to stores. It focused on the quality of its coffee with a Coffee Master training program for its baristas and a new line of ultra-premium whole-bean coffees. It even tried adding value by offering Wi-Fi service and creating and selling its own music.

But none of these actions seemed to address the core problem: Although Starbucks still charged a premium price, it was no longer a special place. As the recession tightened its grip and more people cut back on discretionary purchases, the problem only grew worse.

Compounding the problem was an increase in competition. For years, if you wanted a latte, Starbucks was about the only option. But now, not only were Dunkin' Donuts and McDonalds selling premium coffee drinks to the masses, just about every mini-mart in the country boosted the quality of its coffee. All of these competitors had prices considerably lower than those of Starbucks, which made the most well-known coffee bar much less justifiable to the "grab and go" crowd. As much as Schultz denied being in direct competition with the lower-status coffee pourers, many critics seemed to be thinking the same thing; that Starbucks had shifted from a warm and intimate coffeehouse to little more than a filling station, battling fast-food outlets for some of the same customer dollars.

"Value" to the Rescue?

As Schultz made his address at the shareholders meeting in the spring of 2009, his core message sounded a lot like the strategies of retailers everywhere. He emphasized that the company would focus on "value" in an effort to curb its declining numbers and bring more customers to Starbucks more often. "Starbucks has got to demonstrate to our customers and the marketplace that we can still be a premium brand and create a premium experience and at the same time, create a platform for value," Schultz proclaimed. There was no talk of reducing prices of existing products. Rather, Schultz focused on a plan to educate consumers and employees that Starbucks really wasn't that expensive. "In the coming days, we're going to arm our consumers and partners with the facts about Starbucks coffee." In an effort to dispel the "myth" of the four dollar cup of coffee, he rattled off statistics: 90 percent of Starbucks' coffee drinks sold cost less than four dollars, half cost less than three dollars, and one-third cost less than two dollars.

To enhance its value positioning, the company prepared to unveil two new product initiatives: breakfast combos and instant coffee. Observers quickly surmised that both of these efforts appeared to be recessionary reactions that targeted Starbucks' lower-status fast-food competitors. But Schultz defended both new products, claiming that the company had been working on a premium instant coffee for 16 years. "It just happens to fortuitously coincide with the downturn in the economy," he said. "It wasn't planned that way."

The breakfast combos, or "breakfast pairings," as the company calls them, combine a coffee drink with either an egg sandwich, a cup of oatmeal, or coffee cake, for $3.95, cutting $1.20 off the price of the items purchased separately. The instant coffee, dubbed *Via*, would ultimately be available in single-serve packets at all stores as well as in grocery stores at $9.95 for 12 packets. Starbucks could then promote a genuine cup of Starbucks coffee for under a buck. Promotions to tout the new coffee would make clear that Starbucks wasn't moving downscale, instant coffee was moving upscale. At a New York taste testing, Schultz told a group of analysts, journalists, and retailers that he was ready for the critics who say, "'This is desperate, this is a Hail Mary pass, this is off-brand for Starbucks.' We are going to reinvent the category. This is not your mother's instant coffee."

But Starbucks also made clear that it was not above price promotions. It would offer different types of discounts to different types of customers as it had in the past. Its $25 Gold Card, already in circulation, targeted the less price-sensitive loyalist with various perks including a 10 percent discount on food and beverages. The budget-conscious, less frequent customer would be targeted with promotions like a free, brewed coffee every Wednesday for eight weeks. "We're not just dropping coupons," said Terry Davenport, Starbucks' chief marketing officer. "Value has to be authentic to us. It has to feel like it's in the brand's voice in a way that rings true to our customers."

But after Starbucks' profits dropped 77 percent over the previous year in the second quarter of 2009, value started looking more like it did for the rest of the quick-serve food industry. After avoiding the issue for so long, the world's largest purveyor of premium brew announced that it would lower prices. Rather than an across the board cut, the price of its more basic drinks would be reduced by as much as 45 cents, bringing the price of a "grande" iced coffee to less than two dollars. In order to at least partially offset the cuts, the price on some of its more complex drinks would be raised. Admitting the obvious, Ian Cranna, director of foods at Starbucks, said, "Increasingly today, there is another segment of customers for whom, in all honesty, it's all about the price point."

Despite the value initiatives and store closures, Schultz still hasn't backed off his goal to someday operate 40,000 stores worldwide. With only one-fifth of the chain's sales coming from outside the United States, the company sees a great deal of potential abroad. This brings with it the challenge of making the Starbucks brand relevant to an increasingly larger and more diverse base of customers. *Via* will help, as 40 percent of global coffee sales are instant. But in addition to dealing with customers old and new, Schultz is going to have to continue in the quest to recast Starbucks as "affordable" without harming its premium brand image. And as the competition gets more intense, that may be a tough order to fill.

Questions for Discussion

1. Using the full spectrum of segmentation variables, describe how Starbucks initially segmented and targeted the coffee market.
2. What changed first, the Starbucks customer or the Starbucks experience? Explain your response by discussing principles of market targeting.
3. Is Starbucks' "value" positioning targeting a new type of customer or simply appealing to existing customer types?
4. Will Starbucks' "value" efforts work? What alternatives did Starbucks have?
5. Is it possible for Starbucks to eventually succeed with its goal of 40,000 stores?

Sources: Claire Cain Miller, "Starbucks Adds Instant To Its Menu," *New York Times*, February 18, 2009, p. 1; Dan Mitchell, "Starbucks Faces Existential Crisis In Downturn," *Washington Post*, March 22, 2009, p. G01; Claire Cain Miller, "Starbucks Addresses the Price Issue, and Breakfast," *New York Times*, March 3, 2009, p. 2; and Janet Adamy and Julie Jargon, "Starbucks Responds to Cost-Wary Market," *Wall Street Journal*, March 19, 2009, p. B4.