

The Competitive Advantages of Starbucks in the Chinese Market and the Success in Recovering from the Coronavirus Outbreak

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Abstract—In 1999 Starbucks brought the beloved western beverage of coffee to China, a predominately tea-drinking country. Through years of development and expansion, Starbucks now dominates the coffee industry in China. In this paper, we will analyze the different market strategies Starbucks implemented and the competitive advantages gained as a result. We will also analyze how Starbucks responded to the Covid-19 outbreak in China and how their advantages were able to generate a smooth recovery.

Index Terms—Covid-19, China, market strategy, starbucks.

I. INTRODUCTION

Starbucks Corporation, an American company founded in 1971 in Seattle, WA, is a world renowned premier roaster, marketer and retailer of specialty coffee. It has about 182,000 employees across 19,767 company operated & licensed stores in 62 countries. Starbucks' two biggest markets are the United States and China, with China contributing 11.3% of its total revenues in quarter 4 of 2019 fiscal year (Q4 FY19). Its success in China was largely thanks to its focused market strategies.

These strategies have enabled Starbucks to achieve fast business growth in China to become the number one coffee retailer with a large margin in a traditionally tea-drinking country. However, the Covid-19 pandemic which first broke out in Wuhan, China in January 2020 has created substantial disruptions to Starbucks' business in China, including massive store closures at the peak of the outbreak. Although the pandemic has largely been contained now in the country, ongoing control measures such as social distancing are creating changes to people's ways of life, including the roles of "third spaces" such as Starbucks.

In this paper, we will review how Starbucks achieved its business success and market dominance, and explore how it responded to the outbreak. We will compare Starbucks to its competitors, in particular to Yum China, who owns KFC and Pizza Hut in China, of their performances in face of the pandemic.

Our analyses show that although both companies were able to recover respectively from the setbacks, Starbucks has been able to achieve a stronger come-back. In our study, we will review how Starbucks' competitive advantages built through its market strategies have not only led it to its

current success in China, but also supported it for a quick recovery from a major business disruption caused by Covid-19.

II. STARBUCKS' SUCCESS

Starbucks first entered the Chinese market in 1999, opening its first store in the China World Trade Center in Beijing, a high-end, prestigious shopping and office complex at the time. In a predominately tea-drinking country, the introduction of the western beverage generated little activity and consumption early on. However, given China's huge population, coffee companies like Starbucks saw the potential in the Chinese market. More than 20 years later, today, Starbucks dominates the Chinese coffee market, with 4,447 stores in over 200 cities according to its Q3 FY20 report. Its journey of bringing the beloved beverage from the west to the east involved many intricately planned steps.

A. China's Customers

China's rising middle class and westernized young population are target client segments for companies like Starbucks. According to an article by China Power, China's large middle class grew from "29 million in 1999 (2% of population) to roughly 531 million in 2013 (39% of population)" [1]. The substantial growth is crucial to Starbucks' development simply because it means more customers will be able to afford its beverages. A Grande sized Latte in the U.S. costs USD 3.65, whereas the same beverage is priced at RMB 30 (USD 4.24) in China. In a country where a bottle of water costs approximately RMB 3 (USD 0.43) in the grocery store, the higher price tag labels Starbucks as a "Western Luxury", a status symbol for the growing Chinese middle class. Had Starbucks entered the Chinese market ten years earlier, only a much smaller portion of society would have been able to afford it, and the results would have been different from today. This idea of "Western Luxury" also appeals to another consumer group, China's young people. "They are very diverse, care about their peer group yet embrace personal expression, are materialistic yet idealistic, and have tastes which can be both nationalistic and international" [2]. For many of them, it isn't the beverage itself that is appealing, it is the idea behind it. According to the Atlantic, "high prices actually entice customers who wanted to show off their new affluence" [3]. The young generation, especially those born in wealthier families, often live excessively to signal their backgrounds. The consumption of high-priced coffee reflects the same motivations behind buying luxury,

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designer goods, as both are seen as “Western Luxury”. Both groups are key to Starbucks’ success.

B. Locations and Atmosphere

According to its Q3 FY20 report, covering the reporting period ending on June 28, 2020, Starbucks currently has 4,447 stores in mainland China. The experience of “Home, Work and Starbucks” fits well with its target demographic groups described above. The cosmopolitan and fast-paced cities often meant that young professional office workers would only be going to two places each day: the office in the morning and home at night. Starbucks recognized the problem and sought to create a middle ground where people can work, refresh, and socialize during the day. This idea of a “third space” came to be very popular in China, especially in the bigger cities. “In order to ‘recapture the coffeehouse feel’, it [Starbucks] redesigned its stores in terms of colour scheme, architecture, lighting, and furniture” [4]. The relaxing yet high-end feel makes Starbucks the number one choice for breaks, business meetings, and hangouts for the well-to-do and trendy. Adding on, by strategically locating their stores in malls and office buildings, it makes it even easier for customers to pick up a cup of coffee without worrying about commuting a long distance.

To further enhance the coffee experience, Starbucks launched its ultra-premium Reserve Roastery project in 2018, opening one of its 6 current global locations in Shanghai. “The affinity we have built with our partners [employees] and customers over the past 18 years in China is special, and we knew we must bring the Reserve Roastery, our boldest, most-premium store ever, to Shanghai”, said Howard Schultz, executive chairman of Starbucks coffee company, in a statement published on Alizila.com. The “amusement park for coffee” is packed every day, with an average of 8,000 customers and sales of USD 64,000 per day, according to Starbucks China. The Reserve Roastery reinforces Starbucks’ goal to establish Coffee as a high-end beverage and integrate it into Chinese culture.

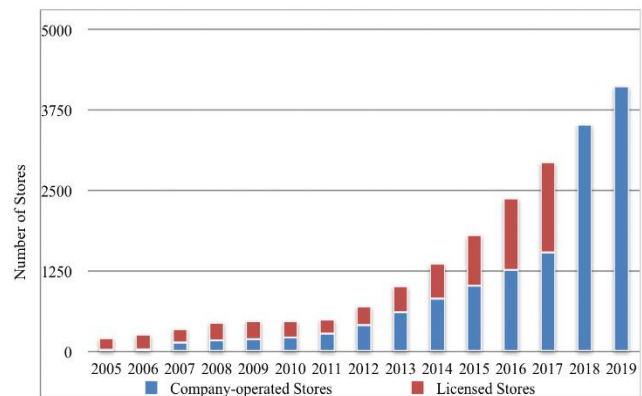
C. Partners and Programs

Coming into the Chinese market, Starbucks made some key partnerships that solidified its success. One of its most major collaborations was with the Alibaba ecosystem [5], which included key businesses like Ele.me, Hema, Tmall, Taobao and Alipay. Delivery service in China is cheap and fast, and is widely adopted by customers. Ele.me being one of China’s largest food delivery platforms, their service with Starbucks allows customers to order and receive coffee without visiting a store. Starbucks is also building its software and stores into China’s Amazon — Tmall and Taobao. That’s a move that Starbucks President and CEO Kevin Johnson told CNBC would operate “similar to the mobile app embedded right into that experience”. The Starbucks Reserve Roastery in Shanghai is also powered by Alibaba’s mobile Taobao App and the company’s augmented-reality technology, allowing customers to point their phones at key features around the Roastery and acquire new information from a digital tour guide. Their collaboration is important as it substantially boosted the beverage company’s digital and physical presence in China.

Starbucks also runs a loyalty program in China, “My Starbucks Reward.”[6] Customers will first need to

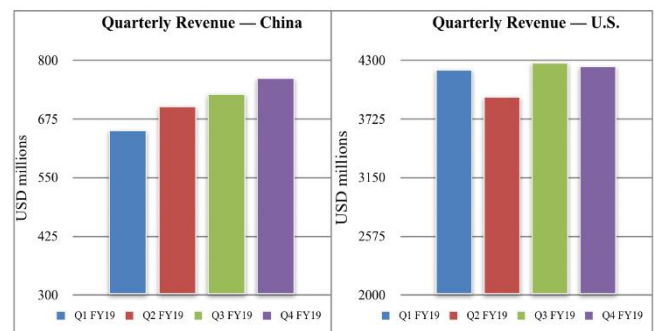
purchase a card, giving them a membership status. With every RMB 50 (USD 7.08) spent, members are rewarded one star, accumulated over time to receive more benefits. The benefits are certainly worthwhile for customers who buy the beverage on a frequent basis. Seasonal drinks, gifts and rewards are also notified to members through the mobile App. According to Restaurant Business, there are 17 million U.S. members of Starbucks Rewards, while there are about 10 million Chinese members of Starbucks Rewards. Considering the U.S. having about 15,000 stores and China only having 4,300 stores, there is a much higher penetration for Starbucks Rewards customers in China. The App entices customers to buy into the Starbucks experience, integrating the beverage into their daily life and further increasing its customer affinity.

By executing these market strategies, Starbucks has established its key advantages on loyal customer base, strong brand presence, and unique customer appeal. These factors have supported its growth and success in China so far as seen in its growth of number of stores [7] (Fig. 1) and its revenue growth (Fig. 2). They will continue to support China to become one of Starbucks’ fastest growing regions.



Source: Statista Research Department

Fig. 1. Number of Starbucks stores in China.



Source: Starbucks FY19 Quarterly Reports

Fig. 2. FY19 quarterly revenue of China vs U.S.

III. COVID-19 IMPACT

In this section, we will analyze in detail how Starbucks China's three competitive advantages support its business growth and development. We will use the ongoing Covid-19 outbreak as an example to further illustrate this point. In this review, we will also compare Starbucks' performance versus Yum China in the face of the pandemic, to support our conclusion.

A. Response

The ongoing Covid-19 outbreak has triggered an unprecedented wave of travel bans, lockdowns, and border closure. China, the epicenter of the outbreak, was the first country affected. According to South China Morning Post [8], China's economy had shrunk by 6.8% in the first three months of the year as malls, cafes, restaurants and other hotspots for crowds to gather were temporarily closed down. Third spaces are one of the most vulnerable in this situation and are affected significantly. Covid-19 had devastating effects on Starbucks in China, whose mission was to bring customers a third space. During the peak of the outbreak, the company temporarily closed approximately 80% of its stores in China, operating the rest on restricted time and staff. Financially, Starbucks reported their sales in Q2 FY20 (ended March 29) to fall by around 50% in China, or as much as \$430 million, compared to the prior year according to Starbucks' SEC filing Form 8-K. Starbucks' stock price also fell more than 25% over the months of January and February.

Starbucks implemented a number of safety protocols to cope with the pandemic, to protect the safety of its partners (i.e. employees) and customers, and also to lessen concerns and restore confidence from its customers:

- All partners must undergo daily temperature checks and wear masks at all times;
- "Safety station" installed at every Starbucks store entrance to check each customer's temperature and ensure they wear masks before entering;
- "Contactless Starbucks Experience" introduced leveraging its mobile ordering capabilities for contactless services through pickup and delivery;
- Limited lobby service and minimal café seating; and
- Enhanced café sanitizing protocols.

As the outbreak was gradually contained in the country, Starbucks was able to reopen most of its stores and recover fairly smoothly with these measures despite the setbacks. As of June, 99% of stores were reopened according to its Q3 FY20 report, ended June 28, 2020. The Reserve Roastery in Shanghai also reopened its doors in early March.

B. Choosing a Comparative

When analyzing Starbucks' performance in face of the Coronavirus, we tried to benchmark it to its main competitors in China. Research was done into two of them—Luckin Coffee and Costa Coffee. Luckin Coffee, one of Starbucks' fierce local opponents, did not have the same smooth recovery. Before the pandemic, Luckin actually had more stores than Starbucks. Though it was a young brand, only three years of age, its growth was incredibly fast, reporting \$216 million in 2019 Q3 revenue, a massive increase from their \$35 million posted in the prior-year quarter. However, being a young brand also meant that Luckin had neither the loyal customer base nor the long-established brand presences Starbucks enjoys, and had to rely heavily on advertisement and discounts to sell its products. It finally imploded under financial stress, as the company was involved in a \$310 million accounting fraud. As of July 2020, the company was delisted from New York's Nasdaq stock exchange, only 15 months after it went public. Because of the accounting fraud and integrity issue

of its financial data, Luckin Coffee is not used for comparison.

Costa Coffee is the second largest competitor to Starbucks next to Luckin. However, since Costa is privately owned by Coca-Cola, its detailed financial and operational data are not disclosed.

Given the above, Yum China is used as a comparable to assess Starbucks China's performance in terms of recovery from the pandemic.

Yum China operates several chains including KFC and Pizza Hut, and has over 8,000 restaurants in over 1,100 cities in China. Recently, it formed a joint venture with Italian premium coffee maker Lavazza Group, likely to become Starbucks' competitor in the near future. During the outbreak, Yum China closed about 35% of their stores according to its 2020 Q1 results, which ended March 31. Its comparable store sales were down 20% and its comparable transactions were down 15% compared to the previous year according to its Q1 results. Starbucks, for the same period, closed 50% of their stores in China, and its comparable store sales were down 50% and its comparable transactions were down 53% from the previous year according to its quarterly results. Starbucks was hit harder initially because it would be considered by most as non-essential consumption. With traffic restrictions and safety concerns, coffee would be one of the first few items that people would consider to cut back on. From the beginning of April to the end of June 2020, the latest when financial data is available for both companies, we can see that both are recovering from the negative impact from the pandemic. Though both Yum China's total revenues and comparable store sales see improvements, Starbucks' recovery appears to be more impressive as they were able to improve their comparable store sales to only be down by 19% according to its Q3 FY20 report, which ended June 28. As of July, both companies have 99% of their stores open (Table I).

TABLE I: COVID-19 IMPACT ON STARBUCKS CHINA AND YUM CHINA COMPARED TO SAME PERIOD OF PRIOR YEAR

| Jan-Mar 2020 | Starbucks (China) | Yum China |
|-------------------------|-------------------|-----------|
| Store Closure | 50% | 35% |
| Comparable Store Sales | -50% | -20% |
| Comparable Transactions | -53% | -15% |
| Apr-Jun 2020 | | |
| Store opening | 99% | 99% |
| Comparable Store Sales | -19% | -11% |
| Comparable Transactions | -27% | — |

Source: Both Company's quarterly reports

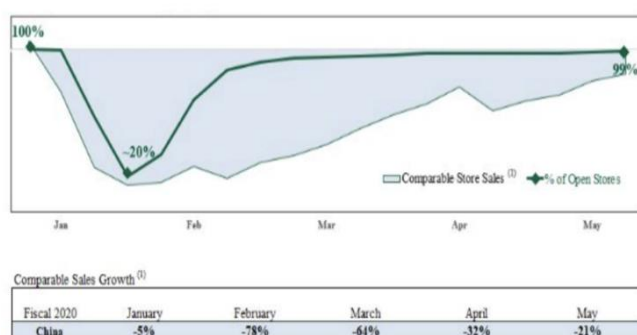
IV. STARBUCKS' COMPETITIVE ADVANTAGES

Although both companies implemented similar safety measures, we believe Starbucks China's stronger recovery from the pandemic is attributable to its three key competitive advantages.

A. Loyal Customer Base

As stated before, Starbucks has a well-defined target customer segment in China. Its value proposition and market strategy have created a nice fit and affinity to this

clientele. Starbucks runs a loyalty reward program in China through the Starbucks App that has seen membership grow rapidly over the years. During the pandemic, customers were invited to attend online classes through the App, where they could learn about everything from latte art to personal development, such as leadership training. A "Partner Assistance Program" was also offered to bring customers together to support each other. These offerings enabled Starbucks to continue to acquire and retain its customers, engendered strong brand loyalty, and built a coffee loving community even during this special period. The loyal customer base is a key differentiating factor for Starbucks China. During this pandemic, when stores reopened and safety concerns lessened, Starbucks China's customers also have quickly returned. As reported in the company's SEC filing Form 8-K on 10 June 2020, the recovery in China which started in late Feb when the comparable store sales was down by 78% versus the prior year, has continued to steadily improve to a decline of 64% in March, 32% in April, and 21% in May (Fig. 3).



Source: Starbucks' SEC filing from 8-K

Fig. 3. Pandemic impact of Starbucks China by month.

B. Strong Brand Presence

Through many years of development in China, Starbucks was able to build a strong brand presence both online and offline. By strategically selecting its store locations, its brand has been often associated with being high-end, modern and intentional, which added to its brand value. In addition, its collaborations with market-leading Alibaba also extended its brand presence digitally online. Whether it is Taobao, Ele.me or Tmall, Starbucks' easily recognizable logo is everywhere in the mobile space. Its online brand presence, coupled with the convenient delivery service in China, proved to be a critical means to support business continuity during the pandemic, when customer traffic was severely reduced due to travel restrictions and safety concerns. Starbucks reported in its SEC filings Form 8-K that during the last week of February at the height of the outbreak and lockdown, mobile orders accounted for approximately 80% of sales mix in China, versus 27% in the last week of March and 22% in the last week of May. These figures still exceeded pre-Covid-19 levels, and was a significant increase from 15% recorded in Q1 FY20, which ended December 29 of 2019. Those figures on one hand show quick customer adoption of new ordering habits, and on the other hand, also demonstrate the importance and power of Starbucks China's online brand to its business.

C. Customer Appeal

As stated before, Starbucks sells more than just coffee, it sells a certain lifestyle. It has become a certain symbol rather than just a daily routine for many Chinese to order a cup of coffee before work, during breaks, or for a social get-together. Though at the peak of the outbreak, around 80% of stores had to close, through elevated cleaning protocols for stores and leveraged new customer experiences, including contactless pickup and delivery services, Starbucks China was able to quickly reopen most of its stores and offer its products. As of June, 99% of stores in China were reopened, of which approximately 90% returned to pre-pandemic operating hours, and over 70% of the stores that are open have full café seating available according to Starbucks' SEC filing Form 8-K. These recovery efforts have been embraced by customers readily, as reflected in the company's latest financial numbers. As to many, going back to their "Starbucks routine" also represents their desire to return to pre-pandemic "normalcy" in life.

V. CONCLUSION

To summarize, since its entry into the China market, Starbucks has adopted a few focused market strategies, including its target client segments, selective store locations, elevated in-store atmosphere, effective customer loyalty programs, and business partnerships especially with e-commerce providers. These strategies have enabled it to build a loyal customer base, a strong brand presence both offline and online, and a unique customer appeal. These differentiating factors have supported its fast growth and business success in China so far. In addition, during the Covid-19 outbreak year to date, Starbucks has been able to achieve a smooth recovery leveraging these competitive advantages in conjunction with elevated safety measures and protocols.

CONFLICT OF INTEREST

The author declares no conflict of interest.

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Hatton Tong is a senior student of Mercersburg Academy, Pennsylvania, USA. He is passionate about business and economics. He started up an online trading program on clothes and got fruitful results. During COVID-19 pandemic, he turned his focus on research of the competitive advantages of Starbucks in the Chinese market and the success in recovering from the coronavirus outbreak to help entrepreneurs

recover from the pandemic.