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Starbucks' Digital Strategy Pays Off as Industry Evolves

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Abstract

Starbucks will continue extending and amplifying its digital advantage, accelerating growth mainly in the US and China through initiatives such as delivery services, ‘Mobile Order & Pay’ and third-party loyalty partnerships.

These digital initiatives should expand its customer base, stimulating the Company’s robust sales trends.

Keywords

Mobile orders
Loyalty program
Delivery partnerships
Scenarios

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Kevin Johnson, Starbucks' CEO, said: "We believe that innovative ideas are fuel for the future, and we continue to build on this heritage".

In fact, Starbucks' digitization strategy will continue to fuel same-store sales and revenue gains, with **loyalty member acceleration** and **increased delivery footprints** mainly in the U.S. and China.

To do so, the Company continues to adapt to evolving consumer behaviors through **Digital Flywheel**, **loyalty program** enhancements and **delivery partnerships**.

1. Digital Flywheel and Loyalty Program

The Starbucks' **Digital Flywheel** includes the **Mobile Order & Pay** and has four pillars: rewards, personalization, payment, and ordering. The Mobile Order & Pay functionality is available on the Starbucks Mobile App and allows customers to place orders in advance for pick-up at certain locations in the U.S. and China. Moreover, Starbucks has been improving Mobile Order & Pay capabilities, like voice ordering, targeted offers and suggestive selling. With these improvements, Starbucks is driving customer loyalty and increasing spending through their mobile app. Currently, 18% of Starbucks' 75 million customers are members of their mobile loyalty program, but they represent **36% of sales**.

Additionally, Starbucks' **stored value card program** provides customers with a payment method, supports gifting and improves the frequency of store visits, in part through the related '**My Starbucks Rewards**' (**MSR**) **loyalty program**. When Starbucks launched 'Mobile Order & Pay' and delivery capabilities, MSR membership went up.

The following table shows the evolution of Starbucks' digitization strategy in the US in the last two years:

	4Q17A	1Q18A	2Q18A	3Q18A	4Q18A	1Q19A	2Q19A	3Q19A	4Q19F
Starbucks Card									
Card as a % of Transactions	40%	42%	46%	45%	43%	45%	48%	46%	46%
y-y bps change	200	200	200	400	300	300	200	100	300
Loyalty Program									
# of Active Members (M)	13,3	14,2	14,9	15,1	15,3	16,3	6,8	17,2	17,6
y-y growth	11%	11%	12%	14%	15%	15%	13%	14%	15%
Starbucks Mobile App									
Mobile Order Transactions as a % of Total Transactions	10%	11%	12%	13%	14%	15%	15%	16%	16%
y-y bps change	400	400	400	400	400	400	300	300	200
# of Stores +20% Mobile Order Transactions at Peak	2.800	3.300	3.600	3.900	4.000	4.300	4.600	4.800	4.900
% of Total US Co-Op Stores	30%	35%	38%	41%	41%	44%	47%	49%	49%

Table 1: Starbucks digitization strategy in the US, 2017-2019

The US 'My Starbucks Rewards' program gained approximately 400k active members in FY19, reaching **17.6M members**, a 15% y-y growth. The program accounts for about **42% of US sales**, up 2% from the year ago. Otherwise, 'Mobile Order & Pay' represents **16% of total transactions** with approximately **4.900 stores** with **more than 20% mobile orders at peak** (representing about 49% of US Co-Op Stores).

Figure 1: Correlation between 'My Starbucks Rewards' growth and US Same-store sales growth, 2016-2019¹

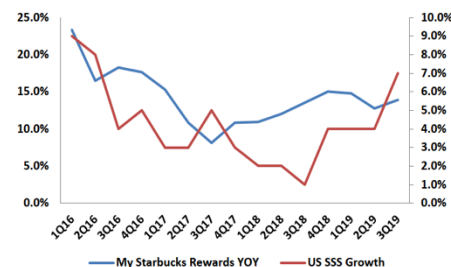
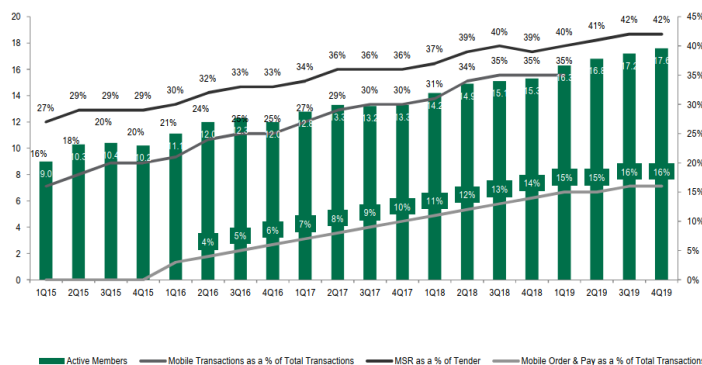


Figure 2: 'Mobile Order & Pay' and 'My Starbucks Rewards' evolution in the US, 2015-2019²



Digital investments are perhaps even more crucial for Starbucks in China, where **digital orders** have expanded from near zero to **10% of the company's business** in FY19, with **7% from delivery** and **3% from 'Mobile Order & Pay'**, its app-based order-ahead feature. Moreover, 'My Starbucks Rewards' program in China reached **10M members**, a 45% y-y growth.

¹ Source: Evercore ISI research and Company Report

² Source: Evercore ISI research and Company Report

2. Delivery Partnerships

2.1. Converting China into a country of coffee lovers

As previously stated, in FY19 digital orders represented about 10% of the Company’s business in China, of which **7% were from delivery**. The Starbucks’ delivery business growth in FY19 was due to a **partnership signed with Alibaba** in the year before.

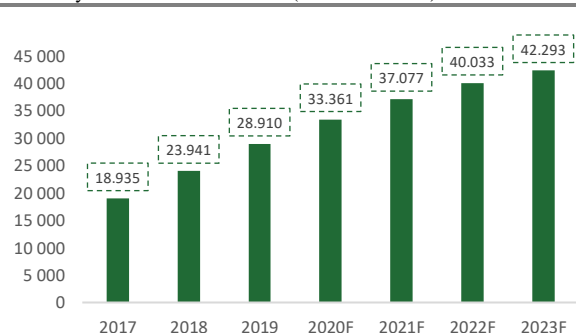
The ‘New Retail’ partnership with Alibaba in August 2018 aimed to offer a better coffee experience to customers, driving growth in China. The Company established ‘Starbucks Delivery Kitchens’ for fulfilling **delivery orders** and to establish a **virtual Starbucks store** for Chinese customers. The partnership involved all Alibaba businesses, including Ele.me, Hema, Tmall, Taobao and Alipay.

In September 2018, Starbucks enhanced delivery of handcrafted Starbucks coffee and tea beverages by using **Hema** stores.

Finally, in November 2018, the company introduced coffee delivery service, the ‘Starbucks Delivers’, in China through **Ele.me** stores. This service is available in about 1.100 Ele.me stores in 17 Chinese cities with full service coverage in Beijing and Shanghai.

Recently, Starbucks announced that it has surpassed the goal of increasing Starbucks Delivers footprint to **3.000 stores in 100 cities** by the end of FY19.

Figure 3: Revenue Forecast for the Online Food & Beverages Delivery Market in China 20-23 (in million USD)³



³ Source: Statista

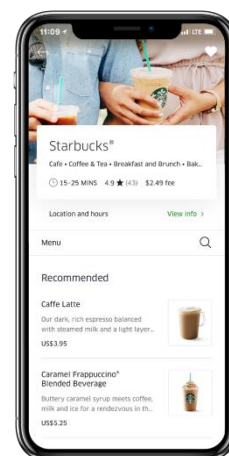
2.2.Coffee at Home with Uber Eats

Although delivery is a much bigger portion of the opportunity in China, it remains a non-factor in the US (as it represents **less than 1% of sales**). However, the recent delivery **partnership with Uber Eats** in the US is about to change this reality.

In January 2019, Starbucks inked a deal with Uber Eats to **expand Starbucks Delivers** across the United States in **11 US markets**. Thus, since January, customers are able to access Starbucks Delivers through the Uber Eats app.

Starbucks US expansion joins delivery initiatives in CAP, tapping into a global **\$95 billion online food delivery market** and that is projected to grow by more than **11 percent annually through 2023**. The expansion in international markets powered by Uber Eats will help the company reach new customers, who are using the Uber Eats platform.

Figure 4: Starbucks on Uber Eats App



2.3. Voice ordering: Taking delivery services to the next level

Starbucks signed a partnership with Alibaba to offer **voice ordering for its customers in China**. Since September 2019, Chinese customers can place orders through Alibaba's smart speaker, which was called 'Tmall Genie'. The voice ordering program uses **Alibaba's Ele.me food delivery platform** and deliveries take on average **30 minutes to arrive** at the customer's doorstep.

3. Scenario Analysis on Starbucks' Digital Initiatives

	Probability	Price (Dec 2020)	Recommendation
Upside Scenario	35%	109,66\$	BUY
Base Case Scenario	50%	94,32\$	BUY
Downside Scenario	15%	87,25\$	SELL
Expected Share Price		98,63\$	BUY

Table 2: Scenario Analysis

According to Starbucks' estimates, digital initiatives will drive **1-2% growth of its comparable store sales increase from FY20 onwards**. The **Base Case Scenario** is the one assumed in the main report, in which it was assumed **1% y-y revenue growth** driven by digital initiatives, resulting in a share price of **94,32\$**.

In its turn, in the **Upside Scenario**, same-store sales (SSS) further accelerate driven by the **online coffee delivery market expansion**. Consequently, it was assumed **2% y-y revenue growth** driven by digital initiatives.

Considering this assumption, the resulting share price was **109,66\$**. The **rising Millennial population** is an important driving force on the online coffee delivery market expansion, because of Millennials desire for a more technological coffee experience. According the National Coffee Association (NCA), 44% of US coffee consumers are Millennial. At the same time, Millennials are now 3 times as likely to order in than their parents. Because of their busy professional and personal lives, Millennials often look for convenience and rely on food delivery apps.

Finally, in the **Downside Scenario**, a conservative position was taken assuming **0,5% y-y revenue growth** driven by digital initiatives. SSS falls short of expectations and decelerates to miss FY20 guide due to **increased competition** in the **coffee retailing industry** and in the **food delivery industry**. Consequently, we reached a share price of **87,25\$**.

Having into consideration the probabilities of occurrence of the three scenarios above presented, it was obtained a final share price of **98,63\$**. Considering Starbucks' current share price of **87,92\$** our recommendation remains **BUY**.