

Research on Financial Risk Management in Coffee Industry under COVID-19 : Evidence from Starbucks Inc.

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ABSTRACT

Based on the huge impact of the COVID-19 outbreak on the world economy, this paper examines the financial analysis of the new coffee industry under the current pandemic. Here we take Starbucks, the representative of the coffee industry, as an example, adopts data collection method, comparison method, etc., and draws a conclusion that the coffee industry has gained development opportunities by taking advantage of its own characteristics in the context of the epidemic from the perspective of liquidity risk and financing capacity. This paper provides a new perspective for analysing the financial situation of the coffee industry and can provide some forecast for the choice of the development direction of the coffee industry under the epidemic situation.

Keywords: Coffee Industry, Starbucks Inc, Liquidity Risk, Financial Capacity, Revenue Forecast

1. INTRODUCTION

The outbreak of novel coronavirus in early January 2020, in China and around the world, had a huge impact on the rapid expansion of China's economy. Because the virus is highly contagious, the most effective precautions are isolation and social, social distance. During the outbreak, the spring break and winter break of students in January and February were the most common meals at the table. [1] Under the influence flash, however, to reduce abortion, travel and travel of the masses cross infections, people on family isolation, travel of Socrates, the real sector of the economy. By march, the epidemic was effectively controlled and began a gradual recovery of production and comprehensive regulation. But during the covid-19 epidemic, there was one industry that was more visible - a new retail industry. It is a relatively new industry, an innovative retail model based on advanced technological methods such as big data, artificial intelligence, etc., the integration of online services, offline experiences and modern logistics depths. Amazon.com was a benchmark for the industry, analyzed as a classic case. The amazon's main driving force is its advanced technologies, which have created an integrated circle of e-commerce, modern logistics, which have laid

a good foundation for the development of its new retail business. [2] In 2018, a new retail center was established, the purpose of which is to sell products in various ways and start rapid development in the new industry.

Starbucks, a Chinese coffee giant, reacted quickly. In order to ensure the safety and health of workers and consumers, Starbucks has temporarily closed a large number of stores since late January and reduced the number of stores to the remaining opening hours, while at the beginning of February about 80% of all stores in China were occupied. The report indicates that in the first quarter sales with the store fell by 50%, to \$3.8 billion, and by 46%, compared to seven billion last year. Since late February, stores have been systematically and cautiously rehabilitated, strict compliance with safety regulations after a reduction in working hours, regular sterilization, constant monitoring of employees' body temperature, restriction of passenger and social connections, etc. By April, Starbucks had resumed its operations almost entirely in Chinese stores and ordered the opening of new stores[3]. Second quarter results show that sales in the second quarter grew 19%, down 19% year-on-year from \$6 billion and 15% from \$7.7 billion in 2019.

Facing with the recovering of the financial performance of Starbucks, we want to figure out that how Starbucks suffer during this period and how it exactly survived and overcame the negative situation, and how it can develop under the trend of opening management of COVID-19.

The paper is organized as follows, section two is business analysis, section three is profitability and liquidity, section four is revenue forecast and the last section is conclusion of the whole paper.

2. BUSINESS ANALYSIS

In this part, the authors used the Five forces, SWOT, value chain method to analysis the strategy of Starbucks and initiated a discussion of the advantage and disadvantage of the strategy, also the authors gived some advises for Starbucks in the business aspect under the COVID-19.

2.1 Porters Five Forces Analysis

Porter's five forces model gathers a large number of different factors into a simple model to analyze the basic competitive situation of an industry [4-5]. There is a moderate threat of new entrants into the industry as the barriers to entry are not high enough to discourage new competitors to enter the market. The threat of substitutes is high. There are many reasonable substitute beverages to coffee, which are mainly tea, fruit juices, water, soda's, energy drinks etc. Bars and Pubs with non-alcoholic beverages could also substitute for the social experience of Starbucks. There are many different buyers in this industry and no single buyer can demand price concession. So, the bargaining power of buyers is moderate to low pressure. The Bargaining Power of Suppliers is Low to Moderate Pressure. The main inputs into the value chain of Starbucks are coffee beans and premium Arabica coffee grown in select regions which are standard inputs, which makes the cost of switching between substitute suppliers, moderately low. The industry has a monopolistic competition, with Starbucks having the largest markets share and its closest competitors also having a significant market share, creating significant pressure on Starbucks. So, intensity of competitive rivalry is high to moderate. Looking at the Porters five forces analysis, we can get an aggregate industry analysis that the strength of forces and the profitability in the retail coffee and snacks industry are Moderate.

2.2 Starbucks SWOT Analysis

The SWOT analysis [6] of Starbucks were arranged in table format and bullet.

Strengths:

- Strong Market Position and Global Brand

Recognition

- Products of the Highest Quality
- Location and Aesthetic appeal of its Stores
- Human Resource Management
- Goodwill among consumers due to Social Responsibly Initiatives
- Diverse Product Mix
- Use of Technology and Mobile Outlets
- Customer base loyalty

Weaknesses:

- Expensive Products
- Self-Cannibalization through overcrowding:
- Overdependence in the United States market
- Negative large corporation image
- American/European coffee culture clash with that of other countries

Opportunities:

- Expansion into Emerging Markets
- Expanding Product mix and offerings
- Expansion of retail operations
- Technological advances
- New distribution channels
- Brand extension

Threats:

- Increased Competition:
- Price Volatility in the Global Coffee Market
- Developed Countries Market Saturation
- Developed Countries Economy
- Changing Consumer tastes and lifestyle choices

2.3 Starbucks Value Chain

The overall value chain [7] of Starbucks showed in Fig 1. Considering the length of paper, only inbound logistics of primary activities and technology of support activities were analyzed. The inbound logistics is that sourcing coffee from diverse coffee beans producers with whom they have great relationships and built-up efficient supply chain management system. And the Investments in innovative technologies like the well like mobile app is the technology development of support activities.



Fig.1 Value Chain of Starbucks

2.4 Differentiation Strategy of Starbucks and Discussion

For the retail industry facing scattered customers, there will be a variety of strategies to choose from, such as differentiation strategy, targeted strategy, and inducing strategy. In Starbucks' corporate practice, they choose a differentiation strategy.

Starbucks' main sales products are coffee and desserts, of which coffee is the mainstay, usually made on-site, desserts are made and supplied by local qualified suppliers according to Starbucks recipes. Therefore, at the level of facing customers, Starbucks is mainly embodied as a coffee shop. Coffee shops can be basically divided into three types, the first is independent coffee shops, such as coffee shops run by independent individuals, this kind of coffee shop is usually small, mainly highly customized, small-volume coffee, and some also offer alcoholic beverages. The second is a chain of large coffee shops represented by Starbucks, which I call the "third space" coffee shop, which can mainly provide a relatively quiet and stable space while improving coffee and related products, which can meet the needs of consumers for coffee and coffee drinking environment at the same time. The third is a chain of small coffee shops represented by Luckin, which mainly relies on price advantages to meet consumer demand for coffee, and cannot provide stable space.

Different brand positioning determines the business strategy of different coffee shops, and Starbucks has chosen the differentiation strategy as its company's main strategy. This is undoubtedly a very effective business strategy for coffee, a consumer beverage that has long been industrially produced. The differentiation strategy allows Starbucks to give coffee a higher spillover value (also known as brand value) in addition to the carriers of caffeine and sugar, allowing Starbucks to perform only a small amount of manual operation at the end, to sell industrial assembly line products at a price close to a small output of handicrafts, and to obtain high enough profits to further solidify the brand image. Solidifying the brand image will enable Starbucks consumers to have a stable user profile, further strengthen consumer self-identification, and form a self-motivating process. As a result, the differentiation strategy allows Starbucks to make very substantial profits, giving it the advantage of independent coffee shops and small-store chains. Starbucks' application of differentiation strategy is not only reflected in its comparison with other types of coffee shops, but also in the formation of differentiated business methods among different consumers (such as handwriting consumers' names on coffee cups, giving different stored value card users different cards and preferential policies, etc.).

For the application of the differentiation strategy itself, I think Starbucks has basically done everything it

can do, and I think it can launch more stored value card business and new customer recruitment plans to expand profit sources and absorb funds. In the future application of strategy, I think that to a certain extent, we can mortgage some of our own stores, and obtain funds with suitable interest from banks to carry out financial business, but such risks will be great. A more feasible way is to use its dominance in the industry to further depress the profits of upstream raw material industrial enterprises and downstream licensed stores and commercial real estate, forcing them to give in to Starbucks enterprises themselves.

3. PROFITABILITY AND LIQUIDITY

Considering the neatness of the layout, the various financial statements used in this section are not directly listed, and all data are quoted from Starbucks Inc (2021) [8].

3.1 Profitability

3.1.1 Common-size analysis

Move to the income statement, there is an obvious detail that the total net income. In 2019, it had a total number of 8396.4 million dollars, when it came to 2020, the net income dropped to 2529.7 million dollars which is a huge loss. However, in 2021, its net income climbed significantly to around 10026 million dollars which even excels the figure in 2019. Actually, the performance of total net income, and I guess that is the reason why it fluctuates. It may be caused by the pandemic of COVID-19, since two parts of total revenue: company-operated stores and licensed stores all had a bad business and sales condition. People all quarantined at home, and seldomly had the chance to go outside and have a cup of coffee. Even Starbucks provides the delivery service, most of people are not willing to choose this way[9]. What is more, the whole operating costs didn't decrease because of the pandemic, instead, its proportion gets higher, the reason would be the higher costs of purchase and labor since everything's prices got higher in 2020. But after the outbreak of pandemic, the revenue had a sharp increase, and the costs also be controlled at a very efficient level.

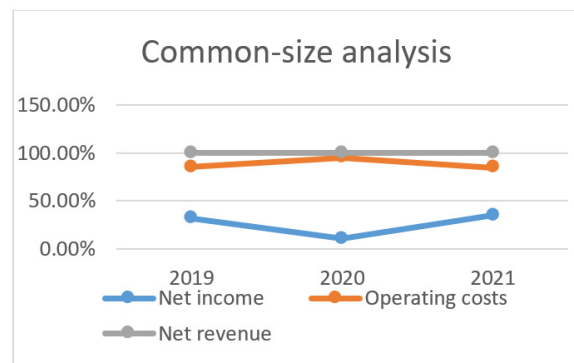


Fig.2 Common-size analysis for profitability

3.1.2 Ratio analysis

First and foremost, the performance of net income can be clearly proved by profit margin, it goes from 0.32, 0.11 and 0.35, this can lead to an analysis to the change of revenue and the cost of sales. On one hand, the net revenue in the last 3 years is also fluctuate. In 2020, due to the outbreak of COVID-19 pandemic, the net revenue sharply decreased from 26508 million in 2019 to 23518 million. On the other hand, the amount of operating expenses in 2020 kept the pace with the amount in 2019. Unquestionably, the profit of 2020 drastically fell down and the profit margin went to 0.11. However, the profit margin recovered to the regular level in 2021, which means Starbucks made effective economic strategies in the face of its financial crisis in 2020. Those strategies may be related to its price change [10].

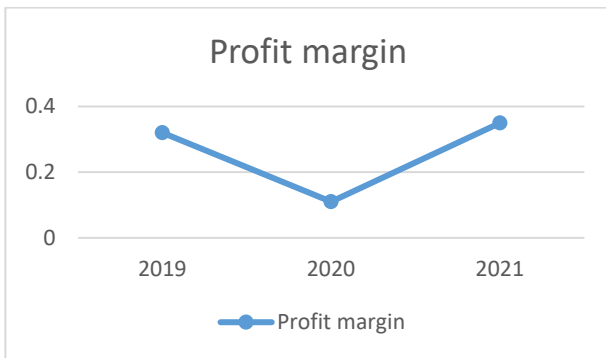


Fig.3 Ratio analysis for profitability

3.2 Liquidity

3.2.1 Common-size analysis

In the balance sheet, we can find that the amount of total assets gradually increased between 2019-2021. A large amount of component would be cash and cash equivalents, and it occupied a percentage of 13.98, 14.81 and 20.56 from 2019 to 2021, which turned out that the company had a good performance in liquidity, having enough cash to keep business running. As for the total liabilities, its amount also increased from 2019 to 2021, and in 2020, it came to the largest amount to 37174 million, which shows that the outbreak of COVID-19 made Starbucks had more debts that was an adverse effect to liquidity. Beside external factors, internal factors also affect Starbucks' liquidity which related to our ratio analysis. It is easier to improve Starbucks' internal performance which is related to corporate governance rather than change the external environment [11].

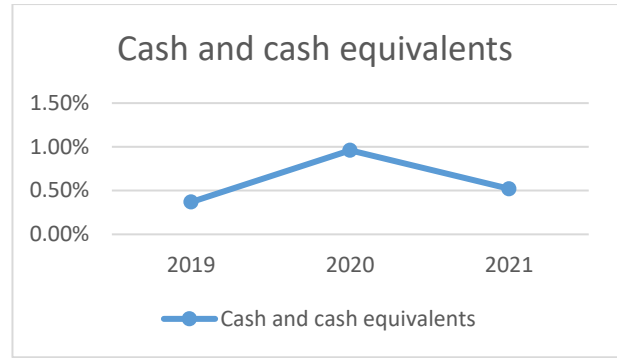


Fig.4 Common-size analysis for liquidity

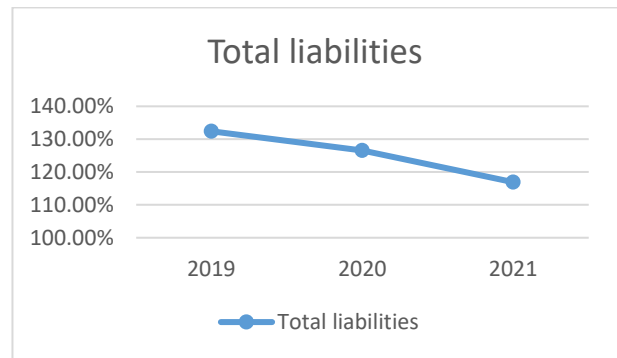


Fig.5 Common-size analysis for liquidity

3.2.2 Ratio analysis

As we calculated, the operating days were negative which can prove that money is adequate within the business and it's unnecessary to get other finance. Moreover, the current ratio (1.32, 1.06, 1.20times) increased trend which shows the power of increasing cash. After deducting the number of inventories, still the quick ratio (0.67, 0.85, 1.00times) is evidence of good performance of all current assets. Other large component of assets includes PPE and Lease property, they perform at a stable level. In balance statement, we can also take a look at the figure for accounts receivable turnover, compared to the account payable turnover, they both grew along these three years, but the figure for accounts payable turnover would higher than the figure for accounts receivable turnover, which shows that Starbucks give its customers less days to pay back the money, and the suppliers give Starbucks a longer period to pay back the bills. This shows Starbucks powerful brand and its reliable and trustworthy brand. In terms of accounts receivable turnover, the Starbucks should attempt to shorten it, in case of bad debts happening a lot. But for the figure for accounts payable turnover, the company can't make it continue to lengthen, which will make the investors think it has a problem of returning the money but the fact is opposite. Also, the figure for current ratio I mentioned above is higher than 1, which shows that there would be a large amount of non-current liabilities, being proved in the balance sheet. And the

gearing ratio can prove that the level of long-term equity (1.79, 1.88, 2.56times). Besides, there is a gearing ratio about long-term debt divided by equity which is negative since the shareholders' equity is negative, since the retained earning shows a huge deficit. The reason for this would be the huge loss (after total net income, there are still some deductions which had been hidden but the final results would be negative). However, this number is gradually back to the positive trend which would take estimated 5-10years. The factors would be some instruments or securities that the business should pay huge importance to.

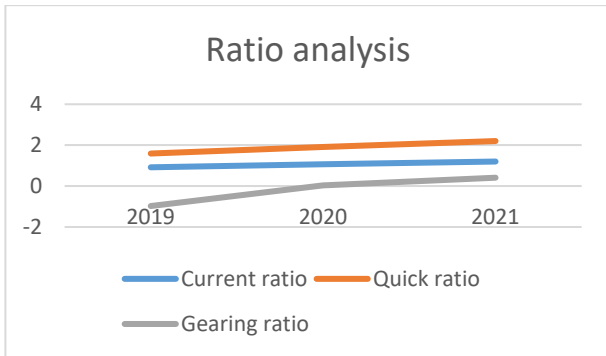


Fig.6 Ratio analysis for liquidity

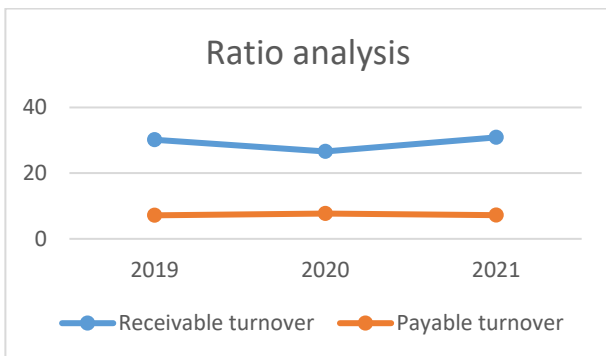


Fig.7 Ratio analysis for liquidity

4. REVENUE FORECAST

4.1 Qualitative Aspect

For the qualitative aspect, since sales revenue equals to sales volume times sales price, the revenue drivers can be analyzed from these two parts. The factors that affect sales volume are about firm-specific strategy and industry-specific situation. As a matter of fact, Starbucks' drinks are usually expensive and thus the customer base it targets are the people who are living a not that poor life. So, although Starbucks, this brand, is renowned all over the world, however if it wants to an achieve a thorough penetration in whole market, those constructors or blue-collar workers should also be considered to truly achieve an entire penetration of the whole market. For the industry-specific aspect, the whole drinking and coffee industry has been crashed over the period of COVID-19.

People were forced to quarantine at home which led to the bad performance of physical stores for the whole drinking industry. However, things are under control for most countries right now, especially for some western countries who have implemented the opening management. Thus, most of the physical shops have been resumed to the normal situation which makes the sales volume back to normal.

Moreover, the sales prices may also be influenced by two factors: firm-specific strategy and runaway inflation. Based on the previous analysis, Starbucks' strategy is about focused differentiation strategy since it aims to provide customer uniqueness of enjoying coffee which leads to the high prices of coffee. However, if it wants a small group of customers to be convinced to buy a more expensive drink, adding cultural features and flavors according to the local culture and habits in different regions, which is an innovative way to increase the genre and improve the quality of coffee. Another influential element is the runaway inflation which affect people's life, making them struggle to keep up with. Recent war between Russia and Ukraine has aggravated the situation there, since a lot of countries shut down the channel for inter-transaction with Russia, which means that the supply or input of some ingredients of coffee would be affected which continues to cause the higher costs of coffee especially in western countries. And this factor heavily depends on the government policy to ease the burden of inflation to many people.

4.2 Qualitative Aspect

Regard with the quantitative factor, the most noticeable part is that Starbucks always report its revenue in the category of geographical difference and business entities difference.

Starbucks revenue breakdown by geographic segment: 70.1% from United States, 17.2% from other countries like Japan, Canada and the UK. and 12.6% from China Starbucks Income Statement Annual. As of 2020, the number of stores in the US (15,328) is more than three times than the stores in China (4,704). However, for the total revenue in 2020, the figure for US is about 8 to 9 times than China. Thus, the revenue per store in China is way less than US. In order to move the geographic revenue forward positively, Starbucks could slightly increase the number of stores in China and other countries except for US, but the focus should be improving the revenue performance per store in these areas.

Another category is company operated and licensed store. From the income statement, the former outperformed than licensed store, since some licensed stores were located at area hit most by COVID-19. As a matter of fact, Starbucks in China used to be licensed after the acquisition in 2019, and the performance of

China market had increased significantly. Thus, Starbucks could improve its revenue from injecting capital in other nation's market to own the store entirely by themselves which may require other resources of capital.

5. CONCLUSION

From the above research discussion and analysis, this paper draws the following three conclusions:

1. For a company that has been in the beverage retail industry for many years, Starbucks has its own unique advantages and disadvantages. Years of experience in the coffee field and mature upstream and downstream channels enable it to dominate the entire retail chain. According to Porter's Five Forces Analysis and SWOT analysis, Starbucks has obvious advantages and not fatal disadvantages in its industry. But for new competitors from joining the industry, it is difficult to respond flexibly to their challenges. Considering the average tenure of a Starbucks CEO, the company's strategic turn has been equally difficult. At the same time, thanks to this, Starbucks can maintain its dominant position while maintaining a differentiated strategy to provide employees and investors with stable and predictable returns.

2. From the analysis of the balance sheet, it can be seen that due to the impact of COVID-19, marketing costs, labor costs and procurement costs have not been significantly reduced, and the sales of franchised and directly-operated stores have dropped significantly, which has jointly led to 2020 saw a sharp drop in overall revenue and profits. However, the profit margin in 2021 has returned to a relatively high level, even surpassing that in 2019. This is due to the entire industry chain affected by the epidemic. Starbucks, as the leading company in the industry and has a dominant position in the industry chain, this enables him to recover better and faster and seize more profit margins than other companies during the recovery phase of the epidemic.

3. For the future profit forecast, from a qualitative point of view, under the influence of out-of-control inflation and limited market, Starbucks needs to expand its customer base in order to obtain greater profit margins. Difficulty opening up a market among workers with a broad need for caffeine and sugar. Nearly 1/4 of Starbucks' profits come from China, but due to restrictions on epidemic control, sales in China may be difficult to recover in a short period of time. Elsewhere in the world, profit margins can be forecasted steadily against growth trends over the past few years as governments loosen their grip on the COVID-19. Starbucks revenue would gradually go back to the normal level at the beginning of the next five years and for the company-operated store, the growth rate would start from 29.00% and rise for extent from 0.5% to 1%, and for the

licensed stores will grow slower than company-operated store at the beginning, but once the cumulative capital is enough, it will have a remarkable rise in its revenue performance.

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