

Reimagining Retail: Why Starbucks is struggling and how they can turn things around

Audio



On today's podcast episode, we discuss what Chipotle has that Starbucks is trying to gain, how Starbucks can turn the ship around, and what its struggles tell us about the greater retail

world. Listen to the conversation with our analyst Sara Lebow as she hosts analyst Sky Canaves and vice president of content Suzy Davidkhanian.

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Episode Transcript:

Sara Lebow (00:00):

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(00:19):

Hello listeners, today is Wednesday, August 21st. Welcome to Behind the Numbers: Reimagining Retail, an EMARKETER podcast. This is the show where we talk about how retail collides with every part of our lives. I'm your host, Sara Lebow. Today's episode topic is Starbucks.

(00:42):

Before we get into that, let's meet today's guests. Joining me for today's episode, we have principal analyst, Sky Canaves. Sky, what's your Starbucks order?

Sky Canaves (00:51):

It's a hot almond milk latte with an embarrassing number of customizations.

Sara Lebow (00:57):

Also with us is VP of content on our retail desk, Suzy Davidkhanian. Suzy, what's your Starbucks order?

Suzy Davidkhanian (01:03):

I'm not a customer, so I don't really have an order.

Sara Lebow (01:06):

Okay, so spoilers on how this episode's going to go.

Suzy Davidkhanian (01:10):

Well, no, I think we can admire them as a business. I just don't know-

Sara Lebow (01:14):

My order is I never go there, but if I'm at the airport, it's a chai latte with a shot of espresso.

Sky Canaves (01:21):

A dirty chai.

Sara Lebow (01:22):

Dirty chai, yeah.

Suzy Davidkhanian (01:23):

The last time I bought something from Starbucks was their water.

Sara Lebow (01:26):

Was it good?

Suzy Davidkhanian (01:27):

It's water, very expensive water.

Sara Lebow (01:28):

Suzy's Starbucks order is water.

Suzy Davidkhanian (01:30):

Very expensive.

Sara Lebow (01:31):

Okay, now that we know everyone's Starbucks order, let's get into talking about them as a business. Starbucks has been the brand to beat for years. They've been top in brand recognition, loyalty, consumer experience, you name it. But in Q2, same store sales declined for the second straight quarter, which former CEO Laxman Narasimhan blamed on a challenging consumer environment. I say former CEO because as of last week, Narasimhan is out and former Chipotle CEO Brian Niccol is in at Starbucks.

(02:03):

Let's start off with setting the coffee table here. Sky, why is Starbucks doing so poorly?

Sky Canaves (02:10):

I think it's a combination of factors. Economic conditions are a big one. It's hard to justify \$9, \$10 cups of coffee for a lot of shoppers who are looking to cut back. That tends to be one of the first things people will do to save money, is give up their Starbucks habit. Whereas we've seen a competitor like Chipotle still doing well because at least it's a filling meal that you're getting out of it. Then I think other factors are increasing competition and somewhat lack of innovation as well in the offerings. And they're also dealing with some bottlenecks in terms of how their stores fulfill orders, how quickly they can get orders to customers, and that can drive people away as well.

Sara Lebow (02:52):

Are the challenges they're facing in China impacting them as well?

Sky Canaves (02:56):

Yeah, so China's been really the focus of their international growth, and there there's very weak consumer demand for spending in general. It's been pretty soft due to the economic conditions there as well. And they also have so much competition, lower-cost competition from Luckin Coffee that's leading to price wars and also a lot more competition across the coffee and tea space, across the beverage space, that they have to contend with.

Suzy Davidkhanian (03:24):

I also think they lost their core value. Because it was supposed to be an experience. It's supposed to be fun, it's supposed to be cool, it's supposed to be different, like a craft, a premium product that they've commoditized because of many, many reasons. There were many factors that go into the commoditization of coffee and that particular experience. And I think if it didn't feel like a commodity, people might not have been cutting it out even though, because we talk a lot about the lipstick effect. When times are tough, people still need a little moment of self-pleasure. It's just like insult and that's ruined for people when your coffee two years ago was not \$10, it was maybe \$6 and all of a sudden it's 10, and now you're like, "Oh, is it really worth it?" So there's so many things to unpack here when it comes to what is it that's happened. They have a licensing model. Not all of their stores are owned and operated, which is difficult. They are probably over-stored in the U.S.

Sara Lebow (04:21):

Yeah, I feel so silly for, while we're recording this, drinking my \$8 coffee that I got in Brooklyn on the way into the office this morning. Let's keep going with that Chipotle comparison, though. This is apples and oranges, or coffee and burritos, but Starbucks did hire Chipotle's CEO. What does Chipotle have that Starbucks is trying to gain?

Suzy Davidkhanian (04:42):

So I actually think it's the person they're hiring, this turnaround person, who can come and help sort of revive the chain. Starbucks has not been doing well for a long time, and even though they've tried to do quote, unquote, innovation, their ex-CEO came in from a CPG background and they thought maybe that would help at least with a different sort of sense of products maybe at the grocery store, and even that hasn't really worked in their favor. Whereas the Chipotle guy has come in after multiple runs of coming in, seeing a problem, diagnosing it, figuring out how to solve for it and operationalizing super quickly. So I think that's what they're looking for.

Sky Canaves (05:16):

I think having a very innovative and responsive CEO at the helm for the past six years or so is really what has given Chipotle huge advantage and really had seen their business soar to new heights and continue to do well even as consumers continue to pull back. And Chipotle has successfully avoided having to do a lot of discounting or value meals even at this time when consumers are under more financial pressure, as a lot of rivals have done with lower cost options. Chipotle has been able to position itself a bit more as a premium offering. And I think part of it is that it can benefit from wealthier consumers trading down, maybe trading down from dine-in experiences at a restaurant that are a lot more expensive now as well. Whereas Starbucks consumers are not really trading down to Starbucks. There's not a more expensive coffee option that they're leaving. They're trading down away from Starbucks to coffee at home or to maybe less expensive options or just doing without.

Sara Lebow (06:20):

Chipotle has also done a lot of interesting things recently. I just saw on TikTok a beauty collab with E.L.F. They invented or released a Lipotle where you can eat the burrito and the lip stain doesn't come off. Lots of social content, good targeted ads, and yeah, other things of the sort.

[NEW_PARAGRAPH]Suszy, did you have something to add there?

Suzy Davidkhanian (06:41):

I did in that I think it'll be really interesting to see what he does. Because Chipotle, like we just said, it's such a different experience from Starbucks. Chipotle, you go, you eat, you leave kind of quick, right? It's about turn and being efficient. It's a quick service restaurant after all. Whereas Starbucks, the original intention was to just hang out there and to get your work done and meet friends for coffee and spend time there. And that experience is very different. Starbucks moved away from it a couple... and I'm sure COVID didn't help because people weren't going to linger at stores, and everybody was expecting everything to be quick and efficient. So obviously this move towards efficiency equals more commoditization, equals more value driven. Even apparently the loyalty app is all about value driving messages.

Sara Lebow (07:27):

Let's talk about the differences between the Chipotle app and the Starbucks app. Starbucks has a glut in mobile orders that is slowing down services coming from the app. Chipotle, on the other hand, has its own second assembly line coming in for mobile orders coming in from the app. Which one is a better system?

Suzy Davidkhanian (07:46):

So I think that's interesting because right now we're talking about efficiencies. And the efficiencies, obviously, you want people who are trying to use a convenient service for it to be a good experience and not frustrating. But at the same time, that idea of... Imagine even if Starbucks got it right, it's still taking away from the original intention. Do you remember back in the day when someone would write your name and then there were lots of pictures of how they got your name wrong? You don't see that anymore. The fact that Starbucks is trying to use the apps more to get things done faster is also taking away some of that fun premium-ness, whereas at Chipotle they figured out how to make sure everybody's happy, that people are coming to pick up their lunch to go home or back to the office and the people who want to stay in. But you know what? Most Chipotles are not beautiful inside. There is nothing about staying in a Chipotle to hang out. There should be at a Starbucks, at least originally.

Sara Lebow (08:39):

Sky, anything to add there?

Sky Canaves (08:40):

I think the efficiency question for mobile orders is really interesting. It's also one that I think Niccol has addressed at Chipotle with in-person orders, because they've added expeditors to work and help process orders faster, get them paid for and done, and increase the ability to fulfill orders in stores even faster through that. But I think Starbucks has been facing a lot of challenges with bottlenecks through its mobile ordering system because it allows so many customizations that then complicate the ability to complete those orders or to fill them. I think Starbucks has also been looking at how it can become more efficient in getting orders to customers quickly. Because the whole app ordering process is so seamless and easy until you get to the post-purchase and you see how long it's going to take to fill your order. If it's going to take more than five minutes, it's frustrating. And then if that order estimate isn't actually satisfied and it takes much longer than the estimate, that's also very frustrating.

Suzy Davidkhanian (09:42):

I do think they're doing some cool things in terms of trying, they have so many stores, they're trying to differentiate some of the stores and they have different concepts. So there is, not that new anymore, that's just like mobile pickup store by me that seems more efficient because that's all they're worried about, right? But it is weird to think that one store location can't handle both. Can't you figure out how to make that work in terms of your employee structure? And just think about the takeout lanes, the drive-through lanes. There are someone that's filling that order that's separate from the person at the front of the store who's taking your McDonald's order. So it seems weird that Starbucks can't figure that out.

Sara Lebow (10:26):

One thing Starbucks can figure out or has figured out is Gen Z. They're still doing well with Gen Z. According to consulting firm dcdx, Starbucks ranked as number seven among Gen Z's most magnetic brands of 2023. And this past summer Starbucks added boba, or bubble tea, which is a clear appeal to Gen Z. Is that popularity enough, though, to help Starbucks turn it around?

Suzy Davidkhanian (10:50):

I don't think so. I think the problem that they're facing at the depths of the core of the problem is that the loyal, loyal customers who, let's say, went four times a week are now pulling back and going two times a week or maybe just once a week or twice a month. It's that shopper that they're losing. The random teenager, Alpha, Gen Alpha or Gen Z, who's going

into the store every once in a while when they get pocket money from their parents, I think that's not where the money is going to be. It's the repeat purchasers, which is why they were trying to do the value meal. But that obviously didn't work, because if you're trying to be a premium company and charge premium pricing, you can't really have a value meal. It just seems so off brand.

Sky Canaves (11:32):

I think with Gen Z, they're facing so much competition from Gen Z's attention shifting more to boba or tea drinks, and there's a lot of competition there. And I think they were on the right track with introducing the Popping Pearls Boba this summer. But I think they've also faced a challenge with scaling that innovation. When they offer innovations, they're challenged to really scale it and be able to offer it and meet the demand for them, because they mentioned that they sold out of boba and then they were out of stock. And I see when I order on the app, they're sometimes out of stock of particular things like oat milk or other things that they should have in stock, like basic bakery items. So they're also losing sales because they're not optimizing their-

Sara Lebow (12:17):

Their inventory.

Sky Canaves (12:18):

... their product mix, yeah.

Suzy Davidkhanian (12:19):

Well, and it's scary about the, sorry, I said inventory, but if you meant product mix, that's even a bigger thing, right? Because they seem to have so many SKUs when it comes to drinks and so many combinations, but not that much food to go with it, at least not in the traditional ones. Because there are a couple of Reserves here, where it's a little bit different and they have thin crust pizza and other flatbreads and stuff like that. But at a regular Starbucks it seems like food is so secondary.

Sara Lebow (12:45):

I want to get to the question that I feel like we've been sort of talking around this whole time, which is that Starbucks' struggle doesn't exist in a vacuum. We're in this greater retail

environment where it feels like everyone is introducing a value menu except for maybe Starbucks, which has pulled theirs back. What does Starbucks' struggle tell us about this greater retail environment?

Suzy Davidkhanian (13:06):

I think that's such a good question. And I guess what it really tells us is that if in a challenging environment, for many reasons, from the economy to an election year to the world is falling apart, if your brand doesn't stand for something and is not authentic and you don't understand your customer at the end of the day and what is it that they're looking from you, the competition is so fierce then that it becomes a value driven sort of nobody's going to win when everybody's trying to cut prices on things, except for the consumer.

Sky Canaves (13:38):

Yeah, I think there's a big challenge because the consumer willingness to spend on expensive coffee drinks is a bit lower than it was a year or two ago. At the same time, I think Starbucks has to figure out where do they want to grow the most? They've talked about in their last earnings call, which may not be valid anymore, because Niccol might come in with a completely different strategy, but they talked about wanting to target those non-Starbucks rewards members, so the less loyal, the less active customers, and bring them back to Starbucks because they felt that was a growth opportunity. But maybe they need to aim higher and aim for their premium most loyal higher income consumer and provide products and offerings and store experiences that really speak to them.

(14:24):

Suzy, you mentioned the Starbucks Reserve stores and the Roasteries. These types of environments might hold more appeal and might ultimately generate better margins for Starbucks, even though it's harder to scale that type of business, because it's a higher service level enterprise and it involves higher quality products and even expanding into better food options as well.

Sara Lebow (14:46):

And more space.

Sky Canaves (14:47):

Yeah.

Sara Lebow (14:48):

Physically, that they don't necessarily have.

Sky Canaves (14:51):

Yeah, but when I was in Italy this summer, in Milan, one of the coffee capitals of the world, I could not get into the Starbucks Reserve store because the line was around the block, and they had security to keep people like me from just walking in and saying, "I just want to have a look around and not even buy anything because I'm just doing research." But that was really an eye-opening experience, that there still is that kind of interest and demand in the brand, and they really need to capitalize on it and leverage it to really position themselves as that premium coffee offering to differentiate themselves from all the other competition that is growing.

Sara Lebow (15:32):

Yeah, I don't know which one of you made this point, but I think that it was a really good point, that people are trading down to Chipotle, but there's not necessarily that consumer that's trading down to Starbucks. It feels like it's a really good time to be a retailer to which people can trade down, but if you are already a premium retailer and no one can trade down to you, then you're going to have a little more trouble, except for with those ultra wealthy consumers that aren't as impacted by-

Suzy Davidkhanian (16:00):

That was Sky and it is a hundred percent. It's true. I also think the other added layer is the trade down, and also there's this movement to local. So if you are a super premium sort of national or global brand and there's a movement to more sustainable local, how do you manage that?

Sara Lebow (16:20):

Yeah, and that's something that's really important to Gen Z. Now, Gen Z is full of contradictions and they'll say they like local and buy from Shein, as many will. That's not Gen Z specific, but we know that Gen Z does like local. So if you are Starbucks, if one of your appeals has been being cool, being young, how do you keep that up? And that's also where

there's the difficulty scaling, right? Because you can do what Barnes & Noble did and have all of your stores have their own individual local feel, but that's expensive and it's difficult to scale.

Sky Canaves (16:52):

And I think that's where the product innovation and the collaborations come in. So looking at the Chipotle app today, I saw a lot of featured meals with Olympians featured and young Olympians, of course. So it's really speaking to Gen Z and generating some more buzz and interest. And, as you mentioned before, Sara, Chipotle has been really innovative with its collaborations, working with brands like E.L.F. on cosmetics collaborations that really speak to Gen Z and their interests and their love of both Chipotle and complementary brands that are part of the Gen Z universe. And they would love to see that. We haven't seen Starbucks do as much on the collaborations front.

Suzy Davidkhanian (17:32):

And if you think about all of that sort of, and maybe one of the reasons why they picked Niccol, is because he's been really good at bringing people back in the different, whether it's Chipotle or Taco Bell, and it's that repeat visitor. It's an already acquired customer. So that's what he's leaned very heavily on. So to your points, if there's more experiences and it's more omni-channel, how do you drive people to the store and how do you get them to buy more in a nice, authentic way? He might really win and turn them around.

Sara Lebow (18:04):

I think that's a good note to end on. So thank you for being here, Sky.

Sky Canaves (18:09):

Thanks for having me again, Sara.

Sara Lebow (18:11):

Thank you, Suzy.

Sky Canaves (18:12):

Thanks.

Sara Lebow (18:12):

Thanks to our listeners and to Victoria, who edits the podcast and keeps things grande. We'll be back next Wednesday with another episode of Reimagining Retail, an EMARKETER podcast, and tomorrow join Marcus for another episode of the Behind the Numbers Daily.