

## Struggling Starbucks' woes could get worse

Economy, competitors weigh on high-end coffee retailer

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Standing in front of industry analysts two years ago, Starbucks executives gleefully proclaimed that the coffee chain's rapid-fire expansion was so successful, it could even support two outlets in one building. Not only that, executives bragged, but the brand was so strong it could be used to sell everything from Scrabble boards to breakfast sandwiches.

Company executives now freely admit that such thinking is largely to blame for the woes that led to Tuesday's announcement that Starbucks will close 600 U.S. stores and eliminate thousands of jobs. The coffee giant's missteps have come at a spectacularly bad time, hitting as the economic slump deepens and consumers are seeing their discretionary spending eaten up by rising gas prices and grocery bills.

If economic woes continue, things could go from bad to worse for Starbucks. Some customers might decide that high-end coffee is no longer an affordable luxury at all, while others might increasingly turn to cheaper alternatives offered by McDonald's and Dunkin' Donuts — companies that have taken aim at troubled Starbucks.

"We are in a world where, anything discretionary, price becomes an issue," said Howard Davidowitz, chairman of the national retail consulting firm Davidowitz & Associates Inc. "Starbucks sells a totally discretionary item."

Looking ahead, some trend watchers say customers could even start to see what was once a nice treat — a frothy coffee drink — as too ostentatious for these tough times.

Anna D'Agrosa, director of consumer insight for Zandl Group, said that in a recent poll of 300 young adults, many mentioned they are no longer drinking Starbucks drinks.

"I think at this point it's really about cutting back, and (has) not gotten to the point where it's not cool to have it, but I think it definitely (could) go that way," she said.

For now at least, plenty of consumers still want a quality drink — they're just watching their costs more when they buy it, experts say. For Starbucks, a big problem is that both Dunkin' Donuts and McDonald's offer a decent coffee concoction, sometimes at a significant discount, Davidowitz said.

"When things were better, I think people preferred Starbucks. The environment is so much better than Dunkin' Donuts," Davidowitz said. But right now, he added, "What I see in the retail numbers consistently is that pricing has become a more important priority."

Mindful of that mentality, both competitors have tried to play up the fact that they offer a coffee alternative for the everyman.

Dunkin' Donuts has run commercials poking fun at Starbucks' drink names and urging its customers to "simplify your latte." McDonald's recent push to offer lattes and other high-end coffee drinks is anchored on the idea that it offers "unsnobby coffee."

Starbucks isn't the only upscale company facing pressure from cheaper alternatives, Davidowitz argues. Whole Foods also is struggling against cheaper grocery alternatives such as Trader Joe's, while cheap chic discounter Target is suffering as rival Wal-Mart fares better.

Starbucks says it does have lower-priced offerings, such as drip coffee or beans that consumers can brew at home, for people who want to spend less to get their caffeine fix. The company also launched a program in the spring that offers perks such as a free shot of syrup flavoring for people who register their refillable Starbucks card.

### Coffee as a commodity

In a way, the competition that now threatens Starbucks is a product of the coffee giant's own making. While other high-end, European-style coffee shops co-existed with Starbucks in its early days, it was Starbucks that pioneered the idea of selling lattes and cappuccinos to the masses.

As a result, Robert Passikoff, president of the brand consulting firm Brand Keys, said customers are now pretty well-educated about coffee and more aware that they can get a coffee drink similar to Starbucks quality at McDonald's, Dunkin' Donuts or any number of local coffee outlets.

What's more, customers who once stayed loyal to Starbucks because it offered other perks such as a plush environment and hand-pulled espresso shots, became disloyal over the past few years as they watched Starbucks take shortcuts in the name of growth.

"If you're not being entertained, and you're not in an environment that is different from the local coffee shop and the McDonald's, and you're not looking at your drink being hand-crafted for you, ... why wouldn't you go somewhere else?" Passikoff said.

Starbucks has said it is working hard to undo some of that damage, including rolling out new espresso machines and getting back to grinding coffee in its stores. It also has eliminated things that are not core to the brand, such as breakfast sandwiches that some people complained made stores smelly.

Passikoff said the risk is that the changes may be too little, too late.

"Now they're going back to the old ways, but people have moved on," he said.

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