

Coffee wars: The Big Three: Starbucks, McDonald's and Dunkin' Donuts

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ABSTRACT

Coffee – for some, a morning cannot begin without it. Many daily rituals include it. It can be seductive, enticing, and addictive. Hard-core coffee drinkers pride themselves on their coffee palettes, their refined ability to distinguish “good” coffee from “bad.” And once a die-hard coffee drinker finds his favorite blend, mountains sometimes must be moved to entice him to deviate from it.

But, for decades, the idea of “good” coffee was synonymous with “expensive.” If a consumer wanted to try the best blends or flavors, he had to be prepared to pay for it. Wallets were emptied, change was gathered, and the coffee-hooked consumer was walking into the coffeehouse ready and quite willing to hand over \$4 to a smiling barista. Perhaps it was true that the coffee was the best to be offered. Perhaps the ambience and cozy atmosphere was a drawing factor. Perhaps it was the label that was associated with it, the feeling that he now belonged to an upscale club or group that not everyone else was entitled to join. Whatever the draw, the consumer continued to come back; day after day, week after week.

Then something happened. The economy began spiraling downward, prices rose, and suddenly, a \$4 cup of coffee was not quite as attractive as it once had been. Enter: The Coffee Wars. Premium coffee shops like Starbucks were suddenly faced with competition from fast food upstarts like McDonald's and Dunkin' Donuts, operations that were abruptly breaking into the premium coffee industry with “cheaper, but *almost as good*, coffees.” Life as the coffee-drinker once knew it had changed forever. For the better? That question remains unanswered as the war continues. But one fact is for certain; the battlefield will never be the same again.

Keywords: economic recession, competition, marketing strategy, market entry

OVERVIEW OF THE ORGANIZATIONS

As we attempt to understand how the Coffee Wars began, it is essential to review the history of Starbucks and its major competitors. Although the number of companies attempting to enter the specialty coffee market is growing, the primary competition right now is coming from McDonald's and Dunkin' Donuts. This case study will review the factors that make Starbucks vulnerable to these competitors, the current state of the Coffee Wars, and develop research questions Starbucks must address if it wants to win more battles than its rivals.

Starbucks

Company History

The first Starbucks store opened in 1971, in Seattle's Pike Place Market. The name was inspired by Herman Melville's *Moby Dick*. Starbucks' chairman, president and CEO Howard Schultz, joined the company in 1982 as director of retail operations and marketing. Schultz returned from a trip to Italy in 1983, with the dream of bringing the Italian coffeehouse tradition of conversation and community back to the United States. When Starbucks did not immediately embrace this concept, Schultz left to start his own Il Giornale coffeehouses. He later returned with the help of local investors in 1987 and purchased Starbucks. It was also in 1987 when the Starbucks opened the first stores outside of Seattle, with locations in Chicago and Vancouver, B.C. (Starbucks Heritage, 2010).

In 1991, Starbucks became the first privately owned company in the U.S. to offer stock options for its full and part time employees. It completed its initial public offering, with common stock traded on the NASDAQ, in 1992. The hugely popular Frappuccino® blended beverages were launched in 1995 and Starbucks joined with Pepsi-Cola to launch ready-to-drink bottled Frappuccino® drinks in 1996. It was also in 1996 that Starbucks opened its first store outside of North America in Japan. The company acquired Tazo Tea Company in 1998, and partnered with Conservation International in 1999, to promote environmentally responsible methods for growing coffee. Starbucks has continued to grow over the years, launching its VIA™ Ready Brew coffee in 2009 (Starbucks Timeline, 2010).

Today, Starbucks has more than 15,000 stores in 50 countries, and is known as the world's premier roaster and retailer of specialty coffee (Starbucks Heritage, 2010).

Mission Statement

As stated on Starbucks' company website:

“Our mission: to inspire and nurture the human spirit – one person, one cup and one neighborhood at a time” (Starbucks Mission Statement, 2010).

The company lives by certain principles every day to ensure achievement of this mission. These principles include creation of quality coffee using the finest coffee beans, embracing diversity in its employees (called partners), building a human connection with its customers, creating a sense of belonging through its stores (havens), being a part of a neighborhood through development of a sense of community, and delivering rewards to all its stakeholders. Because Starbucks understands the importance of social responsibility, and is tremendously dedicated to the “green movement,” it has a separate environmental mission statement.

“Starbucks is committed to a role of environmental leadership in all facets of our business” (Starbucks Mission Statement, 2010).

Starbucks fulfills this mission by understanding environmental issues, using environmentally friendly products, and instilling environmental responsibility as a corporate value.

McDonald's

Company History

Dick and Mac McDonald opened the first McDonald's Bar-B-Que restaurant in 1940, in San Bernadino, CA. After a few months' closure, McDonald's reopens in 1948 as a self-service drive-in restaurant specializing in 15 cent hamburgers. In 1949, McDonald's replaced potato chips with their world famous French fries and introduced their Triple Thick milkshakes. McDonald's future was forever changed when Ray Kroc, Multimixer salesman, dropped in for a sales call in 1954. When Kroc learned the McDonald brothers were looking for a franchising agent, he decided he was ready for a career change. Kroc opened his first McDonald's in Des Plains, IL in 1955, using architect Stanley Meston's trademark Golden Arches and attention grabbing red and white tile building. In 1956, Kroc hired Fred Turner, future McDonald's Chairman (McDonald's History, 2010).

McDonald's sold its 100 millionth hamburger in 1958, opened its one hundredth restaurant in 1959, and introduced its first restaurant with indoor seating in 1962. By 1963, McDonald's had over 500 restaurants, and in 1965 celebrated its 10th anniversary with the first public stock offering at \$22.50 per share. Mascot Ronald McDonald appeared in his first television commercial in 1966, riding his "flying hamburger". McDonald's went international in 1967, when it opened restaurants in Canada and Puerto Rico. McDonald's introduced the famous Big Mac in 1968, the Quarter Pounder in 1973, the Egg McMuffin in 1975 and Happy Meals in 1979 (McDonald's History, 2010).

McDonald's underwent a facelift in 1969 by doing away with the red and white buildings and revamping the Golden Arches logo. Long before social responsibility was an expected part of leadership, McDonalds made history by establishing the first Ronald McDonald house in 1973. Fred Hill, football player for the Philadelphia Eagles, had a need for such a facility while his child was being treated for leukemia, and McDonald met that need. McDonald's opened its 5000th restaurant in 1978, in Kanagawa, Japan. In 1987, McDonald's saw the need to offer healthier alternatives and introduced the Fresh Salad, and later the Snack Wraps in 2006 (McDonald's History, 2010).

McDonald's has introduced some hugely popular advertisement slogans over the years, including "Have you had your break today?" in 1995 and "Did Somebody Say McDonald's?" in 1997. Seeing the necessity for technological advancement, McDonald's launched its corporate internet site, McDonalds.com, in 1996. McDonald's underwent a Global Packaging Redesign in 2008 (McDonald's History, 2010).

In 2009, McDonald's kicked the Coffee Wars into overdrive with the introduction of McCafe coffees, including lattes, cappuccinos and mochas. In 2010, to further promote the coffeehouse atmosphere, McDonald's began offering free Wi-Fi in over 11,000 restaurants in the United States. Today, McDonalds is located in 118 countries around the world. Current McDonald's leadership executives include Jim Skinner, Vice Chairman and CEO, and Don Thompson, President and COO (McDonald's History, 2010).

Mission Statement

As stated on McDonald's corporate website:

“McDonald's brand mission is to ‘be our customers' favorite place and way to eat.’ Our worldwide operations have been aligned around a global strategy called the Plan to Win centering on the five basics of an exceptional customer experience – People, Products, Place, Price and Promotion. We are committed to improving our operations and enhancing our customers' experience” (McDonald's Mission, 2010).

McDonald's strives to achieve its mission through commitment to its seven core values. First, they place the customer experience at the core of all they do. Second, it is committed to its people, training, developing and nurturing its workforce to be future leaders. Third, they believe in the McDonald's System, their business model depicted by the three-legged stool. Fourth, they operate based on sound ethical principles. Fifth, they give back to the community by doing their part to make the world a better place. Sixth, as a publically traded company they strive to grow their business profitably for all shareholders. Finally, McDonald's is a learning organization that strives to continuously improve (McDonald's Values, 2009).

Dunkin' Brands

Company History

Bill Rosenberg opened the first Dunkin' Donuts in 1950, in Quincy, Massachusetts. Rosenberg's philosophy was simple, "Make and serve the freshest, most delicious coffee and donuts quickly and courteously in modern, well-merchandised stores" (Dunkin' Brands History, 2007). Dunkin' Donuts licensed the first of many franchises in 1955. In 1963, Dunkin' Donuts opened its 100th store. Highly popular advertising slogans have included Fred the Baker's "Time to Make the Donuts" in 1982 and "America Runs on Dunkin'" in 2006. In 1999, Dunkin' Donuts celebrated selling its 8 billionth cup of coffee, and in 2000 it opened its 5,000th restaurant worldwide in Bali, Indonesia (Dunkin' Brands History, 2007). A subsidiary of Dunkin' Brands, Inc, Dunkin' Donuts has over 8,800 stores worldwide, with over 6,000 franchised restaurants in 34 United States and over 2,400 shops in 31 countries. At the helm today is Nigel Travis, Dunkin' Brands CEO President, Dunkin' Donuts (Dunkin' Donuts Company Information, 2010).

Allied Breweries of London was formed in 1961, through the merger of three major companies in the United Kingdom. The company purchased Baskin-Robbins in 1973, and bought out Dunkin' Donuts in 1991. Allied Breweries purchased J. Lyons in 1978, creating Allied Lyons. In 2004, Allied Lyons was renamed Dunkin' Brands (Dunkin' Brands History, 2007).

In 2002, revving up to take its place in the Coffee Wars, Dunkin's Donuts launched an espresso revolution with a new line of espressos, lattes and cappuccinos. In 2007, Dunkin' Donuts partnered with Proctor & Gamble to introduce coffee drinks at retail outlets including supermarkets and club stores (Dunkin' Brands History, 2007). Today, Dunkin' Donuts is the world's largest coffee and baked goods chain, serving more than 3 million customers per day. The chain sells 52 varieties of donuts, an array of bagels, breakfast sandwiches and based goods, and offers more than a dozen coffee beverages. Dunkin' Donuts contends that they are the America's largest retailer of coffee-by-the-cup, selling close to 1 billion cups of coffee each year. They encourage its customers to taste the "Dunkin' Difference" (Dunkin' Donuts Company Information, 2010).

Mission Statement

As stated on Dunkin' Brands corporate website, the company's mission is simple:

“At Dunkin' Brands, Inc., our "soul" purpose is to lead and build brands. For more than 50 years, we've been doing just that by leading the Quick Quality segment of the food and beverage industry. Dunkin' Brands goes beyond fast food to deliver innovative product choices at the right price served fresh, meeting the needs of people who are busy living” (Dunkin' Brands Strategic, 2007).

Dunkin' Brands strives to achieve its mission through commitment to its strategic heartbeat, core values and guiding principles. Its strategic heartbeat is “eat, drink, think”. By eat, they mean their brands offer original, fun, quality choices, freshly made, that keep people coming back. By drink, they mean their brands offer trendy, best-in-class coffee and espresso drinks and other signature beverages. By think, they mean their brands succeed at being smart, strategic, values-based leaders in their categories, and in their communities through innovation. The values that guide all that Dunkin' Brands does are honesty, transparency, humility, integrity, respectfulness, fairness and responsibility. The guiding principles that lead to their success are leadership, innovation, execution, social stewardship and fun (Dunkin' Brands Strategic, 2007).

ANALYSIS OF THE BIG THREE

Operational Domain

McDonald's and Dunkin' Donuts are both part of the fast food, convenience segment, but have made strides to improve their image and atmosphere as they began to introduce their upscale versions of specialty coffees. In 2003, McDonalds remodeled its stores, added oversized chairs and softer lighting and colors, and installed free wireless internet service to its customers (Halpern, 2008). They still strive to beat Starbucks on price, by attempting to equal the quality of specialty coffee without the added expense brought by the elegant, homey atmosphere. Where Starbucks stores are all company owned, the McDonald's locations are franchised. This gives Starbucks the ability to maintain more consistency across its locations.

Starbucks is most widely known and sought after for its specialty coffees. Many of its stores offer drive-through convenience, but it is Shultz' envisions Starbucks being the “third place” people gather after home and work (Halpern, 2008). Their setting is one of convenient, fast food combined with an elegant, homey feeling that makes the consumer want to relax and stay a while. Starbucks prices are higher than the average coffee shop, but that is because they choose to differentiate themselves based on quality, specialty coffee and atmosphere as opposed to low price.

The customer is always the top priority, and Starbucks strives to provide a pleasant and satisfactory experience for every customer at each opportunity. From the moment the customer walks into the store, orders their product and either walks out or sits and enjoys the atmosphere, Starbucks pushes to provide the ultimate in coffee shop experiences. While providing a comfortable and relaxing experience for the customer to sit and enjoy, Starbucks provides opportunities for consumers to linger in their stores, providing wireless internet service in an indirect way to keep customers inside the store, lingering over their computers, and then perhaps ordering more products while they are there (Isidro, 2004)

Starbucks as certainly made a name for itself in terms of Corporate Social Responsibility. Seven years ago, Starbucks was the subject of rallies and protests from the Organic Consumers Association (OCA) because of its practice of using milk laced with rBGH in its products. rBGH is a genetically engineered cow hormone that is legal in the United States but has been banned in most other parts of the world. The campaign against Starbucks was intended to force the number 1 coffee seller to cease using milk with this hormone due to possible health concerns. In 1998, Starbucks announced that all of its products would now be rBGH free (Organic Consumers Association, 2009).

In addition, Starbucks is known for its environmentally friendly attitude and has made “even the growing of coffee beans into a cause” (Ligi, 2006). Starbucks continues to support farmers who produce Shade Grown Mexico – utilizing shade trees for growing coffee, which in turn helps build a healthier ecosystem and preserves our natural environments (Ligi, 2006). Starbucks personally operates approximately 8,000 of its stores (located in roughly 10 countries, most in the U.S.), while over 7,000 are licensed and operated worldwide (Hoover’s, 2010). To understand the sheer volume of customers that Starbucks sees, the chain gets approximately 40 million visits a week (Petrecca & Kirchhoff, 2007).

SWOT Analysis

Strengths:

1. Brand equity – no one can compare to Starbucks regarding quality of their product. Others may try to come close, but no one has been able to surpass the Starbucks brand.
2. Customer satisfaction is top priority - the goal is that no customer leaves having a bad experience. Starbucks offers a unique experience, one of a quality product in a comfortable and attractive setting with the pleasant ambiance of a neighborhood stop where friends can gather to catch up on their day
3. Excellent management. The depth of Starbuck’s management pool is extensive; the company has the resources to hire only the best and brightest minds to continue to come up with innovative and exciting new ideas.
4. Corporate social responsibility – the company focuses on being a responsible corporate citizen, making positive impacts on the community, the environment, and even for its own employees.

Weaknesses:

1. Cost of its products is oftentimes double its nearest competitors. In tough economic times, this can greatly influence customer decision making.
2. Response time to competitor promotions and advertising. Starbucks is at the pinnacle, and competitors for their customer base are looking for any way to draw some of that customer pool into buying their product, investing large sums of money on advertising and marketing their new products and it’s comparable value to Starbucks.
3. International expansion compared to competitors: McDonald’s and Dunkin’ Donuts have jumped far ahead in the race to capture the international market, investing a great deal in the foreign market and opening up stores in new locations. The two companies have been successful in capturing an early consumer base, and Starbucks is now having to play catch up.

4. Diversification of services and products: Starbucks' primary product line is very limited, and should the coffee market they hold advantage in begin to falter or people begin to rethink where they are going to spend their next \$4, Starbucks does not have an effective back up plan, or a large and diverse group of other products to attract or retain customers.

Opportunities:

1. The recovered economy leads consumers to feel more secure in making higher cost purchases for luxuries. Starbucks should take advantage of this opportunity with advertising campaigns aimed at drawing frightened consumers back into the process of ordering a Starbucks each morning.
2. Since more consumers are opting to brew coffee in their homes over visiting a coffee shop, Starbucks should focus on expanding its pre-packaged line.
3. Without negatively affecting what they do best – creating an exquisite cup of coffee in an enjoyable atmosphere, Starbucks should begin to focus on diversifying its product line, offering new and inventive products to draw new customers in and keep current customers excited.
4. Starbucks is known for its high-quality coffee, and that quality comes with a price. But it should offer, at least temporarily, discounted rates on various coffees to draw customers in and form habits and patterns that they may continue with even after Starbucks has to gradually raise prices again.

Threats:

1. Competitors who offer quality products at a lower price
2. The economic recession leads consumers to seek cheaper options, or give up higher quality specialty coffee with less expensive options
3. Tough economic times result in customers seeking substitutes for what are considered luxuries, like an expensive cup of specialty coffee. Grocery stores are offering much less expensive options for consumers who choose to brew their coffee at home rather than visit a coffee shop.
4. Several new companies are marketing specialty coffee machines where the consumer can save by brewing their own single serve cups of Joe at home.
5. McDonald's is threatening to take over Starbucks' international business as well, though its McCafe's being opened abroad.

OVERVIEW OF THE SEGMENT

Current State of the Segment

The U.S. has faced an economic recession for quite some time now, leading to a hit in specialty coffee sales. With unemployment rates hitting new highs, the average American has been looking for ways to cut back on luxuries, in an effort to conserve funds. Many are skipping their daily venti skinny half-caf caramel macchiatos, and running by McDonald's or Dunkin' Donuts for their morning cup of Joe. Still others are brewing their own cups in fancy new machines that advertise long-term savings for the consumer (Reiley, 2009).

In a 2009 independent taste test conducted in Tampa Bay, both hot coffee and iced coffee from the big three were compared. The unanimous hot favorite was Starbucks' Pike Peak, with

Dunkin' Donuts Original Blend in second, and McDonald's Coffee in last place. On the flip side, McDonald's came in first place among the iced beverages, with its Iced Mocha. Starbucks' Iced Mocha took the second place spot, and Dunkin' Donuts was in last place with its Iced Mocha Original Blend (Reiley, 2009).

The 2009 National Coffee Association's study of drinking trends cites figures regarding coffee drinking trends. NCA Spokesman Alan Kaiser indicates that only 5% of coffee consumers drink their coffee in restaurants and only 10% take a cup for their commute. More than 80% of coffee consumers brew their coffee at home, while 18% drink coffee at work. This makes the market for pound bags, K cups and Starbucks instant prime areas for growth (Notte, 2009).

Competition

In early 2006, Dunkin' Donuts had 4,100 stores and was statistically the nation's largest seller of nonflavored coffee, holding a 17% market share. McDonald's Corporation was holding 15%, while Starbucks was only 6% (Ligi, 2006). At the time, part of the factor was cost: Dunkin Donut drinks cost at least 20% less than Starbucks' did (Ligi, 2006).

When Starbucks introduced their breakfast sandwiches and drive-through windows, they were in essence beginning to invade into McDonald's territory (Halpern, 2008). McDonald's began taste testing its specialty coffee line in 2005, which was rated better tasting than Starbucks' in 2007 by Consumer Reports magazine (Halpern, 2008). McDonald's premium roast was declared the "cheapest and best" (Reiley, 2009). Starbucks did not take the advancement of McDonald's lightly. Rather, they recognized the threat and quickly joined the battle with their own campaigns and improvements. One of their responses was the announcement they would drop the price of their iced coffees (Reiley, 2009).

Decreased sales of premium coffees due to the recent recession have caused companies like Starbucks to offer discounted prices to retain customers. McDonald's Corp. took advantage of lagging Starbucks sales to offer in all of its 14,000 U.S. locations its McCafe line of espresso drinks (Associated Press, 2009). McDonald's ad campaign aims to have consumers choose their beverage as an affordable alternative to the more high-priced Starbucks products. Starbucks immediately countered by running a full page ad in the Sunday New York Times, touting its drinks as higher in quality than its competitors, and more affordable than consumers might expect. Not to be outdone, Dunkin Donuts announced it would roll back its latte prices 15% (Associated Press, 2009).

In 2008, some McDonald's franchises in the Seattle area erected a billboard in sight of the Starbucks headquarters that simply said "four bucks is dumb." In addition, those same McDonald's locations started unsnobbycoffee.com to help promote the new espresso drinks (James, 2008). Starbucks did not respond in kind, claiming to be taking the high road and that its customer base is different. McDonald's USA President Don Thompson said the company "told the franchisees 'That's not the way we do it,' and they pulled the billboard down" (Jargon, 2009).

In the summer of 2010, Dunkin Donuts offered a Free Iced Coffee Day in 14 locations between the hours of 4:00 pm and 10:00 pm. Starbucks counteracted by offering their Frappuccinos at most locations for half price during that same week, offering their large (venti) size for \$2.50 rather than the normal \$4.75 it usually charges (Noorbaloochi, 2010). Apparently in an attempt to catch up with Dunkin' Donuts' 32-ounce "large" iced coffee beverage, Starbucks has test marketed their own 32 ounce cut called the "Trenta". The cups are taller and

stouter than the “Venti”, and will still fit in car cup holders, a crucial trait for commuters (Johnston, 2010).

Trends in the Specialty Coffee Segment

Economists have noted that, as the coffee wars heat up, as Starbucks, McDonald’s and Dunkin Donuts focus on battling it out for number one, smaller independent coffee shops can no longer compete and are falling by the wayside. In the long run, the bitter competition between the big three will actually benefit them at the expense of many of the smaller chains (Golde, 2009).

Not only is McDonald’s hitting Starbucks hard in the U.S., but they are now giving them a run for their money abroad as well. In 2009, McDonald’s had opened over 200 McCafe’s in Europe and has plans for 200 more to be opened in 2010. These quaint little coffee shops have quickly become top sellers in Europe, and they specialize in coffee served in china cups, croissants and pastries – not a Big Mac in sight. (Liu, 2009).

One of McDonald’s more recent national campaigns touts the idea that “McCafe makes a better day “possible.” McDonald’s admitted that its “coffee push is its biggest menu initiative since it began offering breakfast in the 1970s” (Jargon, 2009). Starbucks fought back equally as hard, running newspaper advertisements telling customers to be cautious about trading down to cheaper coffee. “If your coffee isn’t perfect, we’ll make it over. If it’s still not perfect make sure you’re in a Starbucks” (Jargon, 2009).

Dunkin’ Donuts is fighting hard to stay in the game as well. The week after Starbucks offered a hot-coffee giveaway campaign, Dunkin’ Donuts gave away 16-ounce iced coffee drinks to celebrate the first day of Spring. Dunkin’ Donuts is clearly trying to move past the association customers have with doughnuts rather than coffee. As a result, they’ve introduced an aggressive campaign to promote its new espresso line offered by TV’s Rachel Ray, and has launched its new slogan “America Runs on Dunkin’” (Associated Press, 2007).

Current Organizational Issues and Problems

McDonald’s is well known for its kid-friendly, low price atmosphere. Although they are attempting to change this image through upscale renovations to the stores, consumers still expect inexpensive offerings from McDonald’s. They will find it hard to compete with Starbucks’ specialty coffee line, as customers do not expect to spend \$3 on a cup of coffee at McDonald’s (Halpern, 2008).

As the battle for overlapping clientele in the coffee industry continues to heat up, there is a diehard fan base that simply will not be easy to sway due to the differences in overall experience. For example, Starbucks continues to cater to the more upscale, “yuppie” crowd, and continues to be touted as a “Third Place” of sorts, a place away from the office or home where people can meet with their friends, relax, talk, conduct business, study, and socialize (Golde, 2009).

McDonald’s is not defined as the “it” place to hang out and surf the net, but it does sell good coffee and offers the appeal of value and speed. Finally, Dunkin Donuts continues to appeal to the middle-class and serves more rural markets that are not cost-advantageous enough for Starbucks to enter (Golde, 2009).

CASE STUDY QUESTIONS

1. How can Starbucks continue to increase its offerings of at-home coffee blends, taking advantage of the 80% of coffee drinkers who partake of coffee at home?
2. How should Starbucks increase its advertising campaign efforts in order to convince the public that its product's quality and tastes is not comparable to competitors, and the price is equivalent to the value?
3. What avenues can Starbucks take to help decrease costs while still maintaining its quality levels in order to provide relief to its customers during recessionary times?
4. What can Starbucks do to accelerate its growth in the foreign market, avoiding its competitors gaining a niche with the locals before Starbucks arrives?
5. How can Starbucks remain competitive and diversify its product line, providing other products to appeal to a broader customer base, while also creating other markets to expand in?

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