

# ***Analysis on the Development Strategy of Starbucks' Layout in Third and Fourth Tier Cities in China***

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**Abstract:** Recent surveys found that the stores of Starbucks are mostly located in first and second tier cities in China and its objective customers are high income earners. However, in its 2025 expansion plan, the main objective of Starbucks is to enter low tier cities in China due to the high consumption potential in those cities. In order to help Starbucks achieve its plan, this paper will use the SWOT model to analysis internal strength and weakness, external opportunities and threats of Starbucks. The paper found that Starbucks has high user viscosity, strong monopoly power and financial capacity. Besides, the economic conditions in low tier cities are also beneficial to Starbucks such as low cost on daily life bringing out higher level of disposable income and increasing demand for coffee. In the contrast, we found that Starbucks has several problems such as inefficient chain of command, cost pressure due to large investment on digital technology and poor product differentiation. What's worse, there is fierce battle among other brands and undeveloped consumption concept in the low tier cities. According to the analysis above, we suggest that Starbucks should adopt some strategies such as price discrimination strategy, making product differentiation, increasing investment in digitization and new retail, enhancing the brand influence, seeking for new suppliers with lower prices, shutting down underperforming stores and making improvement on quality of product, service and environment.

**Keywords:** Starbucks, third and fourth tier cities, SWOT analysis, development strategies

## **1. Introduction**

With the rapid development of China's society and the continuous improvement of per capital Gross Domestic Product(GDP). Not only in the first tier cities such as Beijing and Shanghai, but also the demand for high end products in the third and fourth tier cities will increase, which makes Starbucks and other high end commercial brands have a broader market and can also have a place in third and fourth tier cities.

However, except Starbucks, other large chain coffee companies also want to open up a broader market and enter the third and fourth tier cities, this motion makes the market competition of high end large chain coffee enterprises in the third and fourth tier cities extremely fierce. In this

environment, companies must have a clear understanding of upcoming challenges and competitors, and adjust their strategy in time to enable Starbucks to maintain its dominant position in the coffee competitive market.

The main purpose of this paper can be divided into two parts, on the one hand, it enables Starbucks to achieve the expected goals in accordance with the 2025 plan, and on the other hand, it can provide some suggestions to the Chinese government in the supervision or reasonable introduction of foreign enterprises. For the government, the Starbucks is a large foreign company that will cause some obvious effect to Chinese market, the government can refer to this paper to make corresponding market adjustments for the future development of Starbucks. For the Starbucks, market development in third tier and fourth tier cities is a challenging task, the paper is going to provide some advice of the its future market planning and strategic layout for the company and hoping it can provide some effective help.

The paper use the SWOT model to analyze the situation of the Starbucks, including the strength, the weakness, the opportunity and the threaten of the Starbucks. Basing on this model the paper will combine the situation from this four aspects and give out some rational advice.

The rest of the paper is divided into four parts: the second part is literature review, which are the the review base on published papers. The third part is the specific analysis according to the SWOT model. The last two paragraphs are respectively the discussion about Starbucks and the conclusions drawn based on the above discussion.

## 2. Literature Review

### 2.1. Recent Status of Development

According to Zhou, the average revenue of Starbucks' new stores in China is 670,000 US dollars, and its profit margin is 35% the return on investment of a single store is 73% [1]. At present, Starbucks still occupies the dominant position in Chinese coffee stores, and the Chinese market has become a major soil for Starbucks. And it is known to all that China has become the second largest market of Starbucks after the United States According to statistics.

On October 28, 2021, local time in the United States, global coffee giant Starbucks announced its 2021 accounting results for the year ended Oct. 3. Annual financial performance, to investors to hand over a performance of the "success Performance record ", reversing the dismal performance in 2020 amid the COVID 19 pandemic. Revenue of \$29.061 billion and after tax profit of \$4.2 billion is an increase of 23.57% and 354.05% over the 2020 year. At the end of fiscal year 2021, its stock market capitalization reached a new high \$13.055 billion [2]. This kind of reverse in this unusual period of time is well worth of being researched and acquiring knowledge from.

### 2.2. Research in Marketing Strategies of Starbucks

Feng believes that taking the development path of relationship marketing has become the key for brands to attract consumers and it is important to capture the emotional pain points of consumers, increase brand perception, brand attachment and brand loyalty [3]. Besides, Wu uses event analysis to study the relationship between gamely marketing and corporate financial performance [4]. The highlight of the paper is that Starbucks China comprehensively uses three gamification elements of power, mechanism and components to design the membership system, and it will have a positive impact on the company's financial performance, bringing sufficient capital foundation for Starbucks to compete and develop in third and fourth tier cities. In addition, Qin indicates that WeChat platform e-commerce is one of the important channels for many enterprises to develop online marketing [5]. Based on Online To Offline(OTO) marketing theory, he investigates its WeChat public account in the form of literature, interviews, questionnaires. However, there are problems in

the marketing process of "Starbucks China" WeChat official account such as weak marketing function, weak customer development ability, and insufficient marketing service. It is recommended that it should be optimized from the aspects of enhancing user stickiness, expanding popularity and improving marketing services. Also, Li [6] takes the service marketing strategy of Lanzhou Starbucks as the research object. Based on the guidance of 7Ps(Product or Service, Price, Promotion, Place, People, Packaging, Process) marketing theory, she mainly provides some suggestions for the optimization of service marketing strategy, including innovative beverage categories and peripheral products, expanding and extending services, optimizing space utilization and formulated the implementation and safeguard measures of service marketing strategies [6].

### **2.3. Take Starbucks in the First and Second Tier Cities as the Research Object**

Chen [7] suggests the development of Starbucks in China is better, especially in Beijing city where many white collar workers, students and business travelers mind "deep" coffee choice, but also faces the experience marketing desalination, Chinese localization brand problems. Later, in view of its current shortcomings, it put forward distinctive brand management, continuous pursuit of product and service innovation and other suggestions, and strengthen talent training [7].

Additionally, Li [6] takes Lanzhou Starbucks as the research object and proposed that in the new retail era, consumers' consumption habits are no longer limited to traditional offline experience. Therefore, Starbucks brands are faced with problems such as weak performance growth, reduced customer satisfaction and great market competition pressure [6]. Besides, using the method of combining qualitative analysis and quantitative research, Shi and Yang [8] analyzes the spatial distribution characteristics and influencing factors of Starbucks coffee in Shanghai, and discussed the relationship between Starbucks index, the quality of life and the vitality of business circle. The research shows that: (1) The level of economic development, convenient transportation, population density and education are the main factors for the location of Starbucks coffee shop.(2) The Starbucks index or density is the result of the improvement of the quality of life of urban residents and the enhanced vitality of the business circle, rather than the root cause or driving force [8]. Compared with the first tier and second tier cities, the third tier and fourth tier cities have a broader market, but the consumption power of the people in the third tier and fourth tier cities is poor. At this time, the large chain coffee enterprises taking Starbucks as an example need to adjust their strategies and make better development even though.

### **2.4. Research in the Development of Coffee Industry**

Li and Ding find that although the coffee industry is developing rapidly in China, it is still in the primary stage of development [9]. Most of the processed products are primary processed products. Due to the lack of deep processing capacity, a large number of high quality coffee beans are exported to foreign brand enterprises as raw materials. Therefore, coffee producers on China should improve deep processing technology, expand domestic demand, and actively promote brand construction. Besides, Chen does a research on the development of coffee industrial chain and she thinks extending the coffee industry chain plays an important role in improving economic benefit [10]. The coffee industry chain includes planting, processing, sales and other links and it requires close combination and collaboration of all links to achieve maximum benefits. The key to the industrial chain development strategy is to improve the sales link, because the profit space created by this link is huge. Seize the development of this link, the whole industrial chain will have strong competitiveness.

When searching the research literature of Starbucks on CNKI, it was found that Chinese scholars paid more attention to Starbucks. It is found that in the past, scholars have made specialized

research on Starbucks marketing in many fields, and mostly took Starbucks in first and second tier cities as the research object. However, there are few studies on the marketing of Starbucks coffee shops in third tier cities, for the following reasons: firstly, the marketing strategy and enterprise structure of such foreign brands represented by Starbucks may be different from those of local brands; secondly, Starbucks' entry into third and fourth tier cities is a new strategy recently, which still lacks attention and research. Although third and fourth tier cities have received less attention, this booming market has great development potential. This paper will base on the stores opened by Starbucks in third and fourth tier cities, analyze the development and strategy of Starbucks in third and fourth tier cities based on the Swot model, and give strategic suggestions.

### **3. Analysis of Starbucks Based on SWOT Model**

#### **3.1. Strength**

Firstly, the user viscosity in lower tier cities is higher than that in first and second tier cities. It is mainly because of the higher store density in bigger cities, which means more consumers are willing to randomly walk into any store. In the contrast, the smaller number of stores in lower tier cities means higher repeated purchases at one store and higher user viscosity. It is easier to build stronger ties between consumers in these stores. This makes the price elasticity of demand of consumers in lower tier cities tend to be inelastic, which means Starbucks could gain higher revenue and profits when charging higher prices.

Secondly, Starbucks has a large market share in lower tier cities. The large market share could lead to a strong monopoly power, which increases the price setting power of Starbucks. Also, a large market share results in high profiles which make it easier for Starbucks to launch new products.

Besides, Starbucks has made investment in improving digital technology. For example, in September 2017, Starbucks completed all the work of supporting Wechat and Alipay mobile payment in all its stores. In December of the same year, the company cooperated with Alibaba to realize the commercialized application of Augmented Reality large scale scene identification technology in Shanghai stores for the first time. In 2020, Starbucks China launched the concept store of "Ka Kuai", adopting the mode of "ordering online and picking up in store", which optimized the process of self-service consumption for customers, effectively alleviated the competitive pressure of surrounding stores, and improved the product and service quality. As a result, in the first quarter of fiscal 2023, Starbucks China's "special delivery" sales increased 24% year on year, accounting for 29% of sales, reaching the highest so far. This means at the strategic level, Starbucks has the vision to actively try and fully embrace digitalization and new retail. At present, it increases investment in the application of digital means. Such investment in research and development could reduce long run average cost and help Starbucks achieve dynamic efficiency.

Finally, Starbucks adopts division of labor of coffee production. It breaks down the production process into small parts with each other worker allocated with a specific task. There are specialists taking part in the process from coffee bean planting and coffee making. Also, Starbucks made a backward vertical integration—bought its first coffee estate—Alasacia. This can help Starbucks get greater control over the supply chain, which makes it better access to raw materials and reduce production costs. Furthermore, Starbucks pass on the cost savings to consumers, so it remains price competitiveness.

#### **3.2. Weakness**

Firstly, Starbucks faces inefficient chain of command, which lead to communication and coordinate problems. Because of too many layers of management, the company cannot respond quickly to the

changes in demand of consumers. This could slow down decisions making and lead to inefficiency of production. Also, Starbucks has not achieve 100% ownership control of its mainland stores. In view of the different partners in different regions of China, Starbucks China needs to make continuous efforts in coordination and management, and carefully adjust its development strategy.

Secondly, Starbucks faces large financial pressure. Because digital development requires long term investment of capital and technology. Especially during the special period of higher supply chain costs due to the COVID 19 pandemic and higher inflation in the US. In the first quarter, Starbucks reported a 10% year over year increase in general and administrative expenses, with technology accounting for 50.9% of the total. Product and distribution costs, mainly driven by higher supply chain costs, rose 11 per cent year on year, while store operating costs rose 7.8 per cent due to higher spending on employee benefits and training.

What's more, Starbucks doesn't make good performance in product differentiation. The differences in taste and quality of coffee drinks offered by different brands exist but are not great. For example, local brands like Luckin generally use the same grade of Aracabi coffee beans as Starbucks, while MIXUE Ice City's flagship Lucky coffee has a strong price competitiveness. In recent years, many start-up brands and other competitors enter the market due to the low entry barriers. The market share of Starbucks is becoming less and less.

### 3.3. Opportunities

Firstly, the economic development of the lower tier cities is rapid, and their rent and daily living costs are relatively low. Their real disposable gross income is even equal to that of the first and second tier large and medium sized cities, which enables them to maintain good competitiveness despite the national economic downturn and the impact of online shopping, providing more opportunities for investors and huge market potential to be tapped.

Secondly, the chain retail industry in lower tier cities develops rapidly, and the migrant population keeps increasing. Compared with the higher tier cities the cost of building and opening stores is significantly reduced. According to a professional survey, the rent of hypermarkets in Shanghai generally reaches two yuan/square meter/day, while that of third and fourth tier cities is only 0.3-0.5 yuan/square meter/day, which provides great opportunities for the development of urban chain retail.

Besides, as epidemic prevention and control enters a new era, consumer services are recovering. Due to the long term containment of the epidemic, a large number of residents have reduced the opportunity to buy and consume, which makes their consumption desire high, and may carry out a large number of retaliatory and rebound consumption. In addition, due to the epidemic, consumers' consumption psychology may change, making them pay more attention to the quality and enjoyment of life, and increase more spending on life.

What's more, according to the research data provided by iCanData Research Center, the growth rate of new coffee shops in lower tier cities between 2021 and 2022 is 18.52%, which is the fastest among all cities, surpassing the growth rate of 15.91% in higher tier cities. This represents the increasing demand for coffee among consumers in lower tier cities and coffee investors' keen sense of this huge market and business opportunities.

### 3.4. Threats

First of all, the huge business opportunities and market in lower tier cities have attracted a large number of brands to enter the market first. Luckin, Pacific and even MIXUE which have become competitors with Starbucks, have taken the lead in grabbing some consumers by competing with Starbucks in the price war with a lower price range and a large number of free coupons. However,

Starbucks still needs to carefully consider how to further break through through brand value, product quality and other perspectives.

Besides, consumption levels and concepts of lower tier cities are still different from those of higher tier cities. Starbucks faces challenges from consumers' different consumption habits, which not only challenges its uniform price, but also poses great tests to its management, operation and strategy.

Finally, as people become more familiar with Starbucks as an exotic brand, the appeal of its novelty and mystery is gradually fading. Consumers are now more likely to enter a coffee shop randomly, or on the basis of proximity instead of choosing a Starbucks on purpose.

#### 4. The Strategies That Based on the SWOT Model

##### 4.1. SO Price Discrimination Strategy

According to Starbucks' own advantages and opportunities in third and fourth tier cities, Starbucks should adopt price discrimination. To be more specific, the large market share of Starbucks provide a strong monopoly power and thus a high price setting power. Also, the rapid development of economy in low tier cities attract more population from outside. The large consumer base can be divided into different groups of buyers with different PED(Price elasticity of demand). As a result, Starbucks can split the market and then adopt this strategy by charging different prices to groups of buyers of different PED for the same goods and services under the same cost structure.

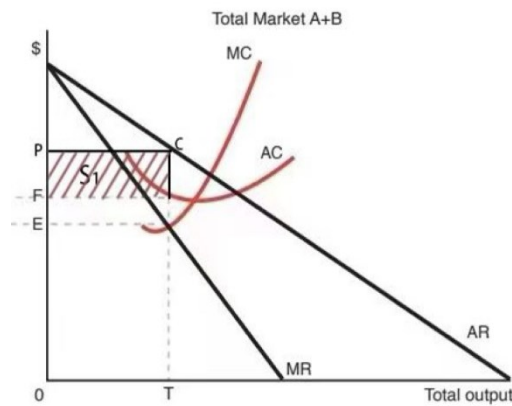


Figure 1: Market A+B.

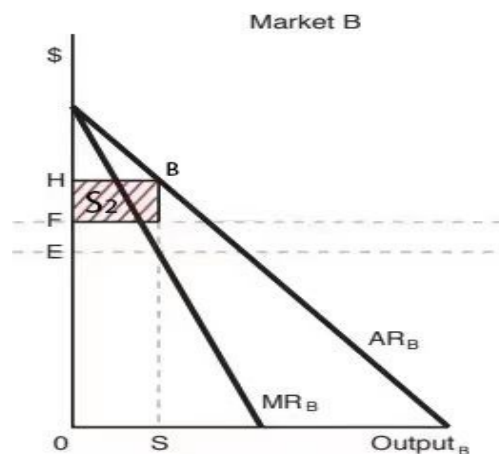


Figure 2: Market B.

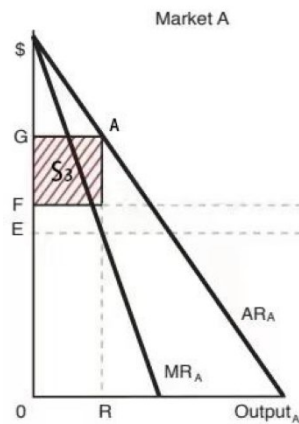


Figure 3: Market A.

Before adopting this strategy, in order to achieve profit maximization, Starbucks should set price at P and produce at T when  $MR=MC$ . The total profit is  $S1$ . As shown in figure 1.

After splitting the markets, Starbucks should charge lower prices for consumers with elastic demand in market B. Because lower prices will lead to a proportionately greater increase in quantity demanded, which lead to higher revenue. As shown in the figure 2, Starbucks should produce at S and charge lower price at H. The profit gained is  $S2$ .

Besides, As shown in figure 3 that Starbucks should charge higher price at G to consumers with inelastic demand such as the middle class in market A. Because this will lead to a proportionately smaller decrease in quantity demanded when price rising to G. Therefore, total revenue will increase. The profit gained is  $S3$ .

$S2+S3>S1$  Therefore, The strategy of price discrimination can increase not only total revenue but also profits. As a result, the implementation of price discrimination strategy is the best choice of SO strategy.

#### 4.2. WO Entry Limiting Pricing and Make Investment on R&D

Starbucks should take advantage of external opportunities to make up for internal weaknesses.

The barriers to entry in the coffee market are relatively low. Starbucks will not only compete with other established large coffee chain enterprises, such as Luckin, but also compete with many new coffee enterprises entering the third and fourth tier cities. Starbucks' mid to high prices are not at an advantage in such competition. In addition, the slow decision making speed caused by the inefficient command chain will also put Starbucks at a disadvantage in the competition in new markets. In order to solve this problem, Starbucks can adopt predatory pricing which means when an established firm in a market is threatened by a new entrant, it will respond by setting such a low price that the new entrant cannot make a profit in order to drive the new entrant out of the market.

Starbucks can also take limit pricing, which means Starbucks should set a low enough price (the limit price) to discourage new entrants from coming into the market. The price has to be high enough for them to make at least normal profit but low enough to discourage any other firm from entering the market. The limit price will be greater the higher the barriers to entry to the market. Or take non price competition such as making investment on technology to improve production process and the quality of coffee.

### 4.3. ST: Use Starbucks' Own Advantages to Avoid Or Mitigate the Impact of External Threats

Starbucks mainly faces external threats from other large coffee chain enterprises and new coffee enterprises entering the market, and other catering enterprises such as Michelle Ice City are also potential threats to Starbucks. The price war caused by the low prices of other enterprises and the difference in consumption concepts and habits in third and fourth tier cities are threats to Starbucks in terms of environment. In addition to lowering the price, a better strategy for middle and high end brands like Starbucks is to make use of its brand influence, use product differentiation strategy. For example, Starbucks innovated a new type of coffee which is combined with China's tea culture. Besides, it can make use of its own brand, maintain long term relations with customers and suppliers, passing on the cost savings from suppliers to consumers by charging lower prices. In addition, Starbucks can also take advantage of its digital technology advantages to increase investment in digital market, developing digitalization and new retail in an all-round way, optimize sales process, and adapt to the trend of the development of digitization.

### 4.4. WT: Starbucks Reduces Its Internal Weaknesses and Avoids Threats from the External Environment

Starbucks has been an established and stable large enterprise with mature corporate structure. Just as Table1 shows that its main weaknesses are reflected in its competitive disadvantages and environment. First of all, as a medium and high end brand, stores of Starbucks are very important. Therefore, the company can close stores with poor performance, focus on developing stores with good performance, and improve the quality of service and environment of stores so as to provide customers with better experience. High price is also one of the disadvantages in third and fourth tier cities, and price reduction is inevitable. Starbucks can find new suppliers and reduce prices while ensuring quality. This strategy can also create its own advantages.

Table 1: SWOT analysis and corresponding strategy.

Internal factors	Strengths	Weaknesses
External factors	1. High user viscosity 2. Large market sheer and strong monopoly power 3. Strong financial capacity 4. Better control of the supply chain	1. Inefficient chain of command 2. Cost pressure due to large investment on digital technology 3. Poor product differentiation
Opportunities	SO	WO
1.Low cost on daily life brings out higher level of disposable income 2.Lower cost on rent 3.Consumers' consumption desire is strong after the pandemic Increasing demand for coffee	1. Price discrimination strategy eg. Provide different price to different consumer online, for instance, provide a higher price to the consumer that often visit Starbucks	1.Entry limiting pricing 2.make investment on R&D
Threats	ST	WT



Table 1: (continued).

1. Battle among other brands 2. Consumption level and concept remain undeveloped 3. The appeal as an exotic brand is fading Fierce	1. Product differentiation eg. Make unique Starbucks products and increase the quality of the product 2. Make investment in digitization and new retail eg. Optimize the online purchase channels 3. Enhance the brand influence eg. Participate in and publicize public welfare activit	1. Seeing for new suppliers with lower prices eg. New stores can offer promotional activities 2. Shut down underperforming stores 3. Make improvement on quality of product, service and environment eg. Refurbished store decoratio
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## 5. Discussion

Digitalization is crucial to Starbucks as a well known coffee chain brand in the world, Starbucks has been actively adopting digital technology to continuously improve its digital capabilities to meet the needs of consumers and accelerate business growth. Here are the reasons why digitalization is important to Starbucks. Firstly, it can enhance customer experience through digital technology innovation, such as introducing digital tools to provide customers with a more convenient and faster shopping experience. Secondly, it can strengthen data capabilities through collecting data from customers and Starbucks, helping to better understand customer needs, improve products and services, and achieve more accurate marketing and sales. Third, it can improve operational efficiency. Starbucks has optimized the back office management system through digital technology to improve employee work efficiency and business management efficiency. To sum up, digitalization is very important for Starbucks. It can enhance customer's experience, strengthen data capabilities, improve operational efficiency, expand markets and revenue, and achieve Starbucks' stability in the global market.

Besides, there are some differences between Starbucks' layout in cities with different development status, mainly in the following aspects: layout density and layout area. Starbucks usually has high density in first and second tier cities and relatively low density in third and fourth tier cities. This is because consumers in first and second tier cities are more likely to accept high priced coffee and coffee culture, while consumers in third and fourth tier cities have relatively low acceptance of coffee, so they need more time to adapt and accept coffee culture. Starbucks stores in first and second tier cities are usually small and relatively large in third and fourth tier cities. This is because in first and second tier cities, Starbucks mainly serves people such as office workers and students. They usually choose to enter the store quickly, order quickly and leave quickly, so the store can be smaller. In the third and fourth tier cities, Starbucks mainly serves social and party occasions, so the store needs are relatively large.

## 6. Conclusion

This paper discussed the current layout and future plan of Starbucks, and then summarized some of the views of previous scholars accompanied by expressing the differences between our analysis and those of previous scholars. According to the research described above, we analysis the strength, weakness, opportunities and threats of Starbucks based on its 2025 strategic plan. We found that Starbucks has high user viscosity in low tire cities, large monopoly power and strong financial capacity. Plus low tier cities cause low cost on daily life bringing out higher level of disposable

income and thus increasing demand for coffee. However, we find that it also face inefficient chain of command, cost pressure due to large investment on digital technology and poor product differentiation, which is accompanied with fierce battle among other brands, undeveloped consumption concept and appeal as an exotic brand. Finally, in order to help Starbucks achieve its plan, we suggest that it should adopt price discrimination strategy, improve product differentiation, make investment in digitization and new retail and take some methods to reduce costs.

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