

Coffee Shop

Industry Snapshot

January 2012



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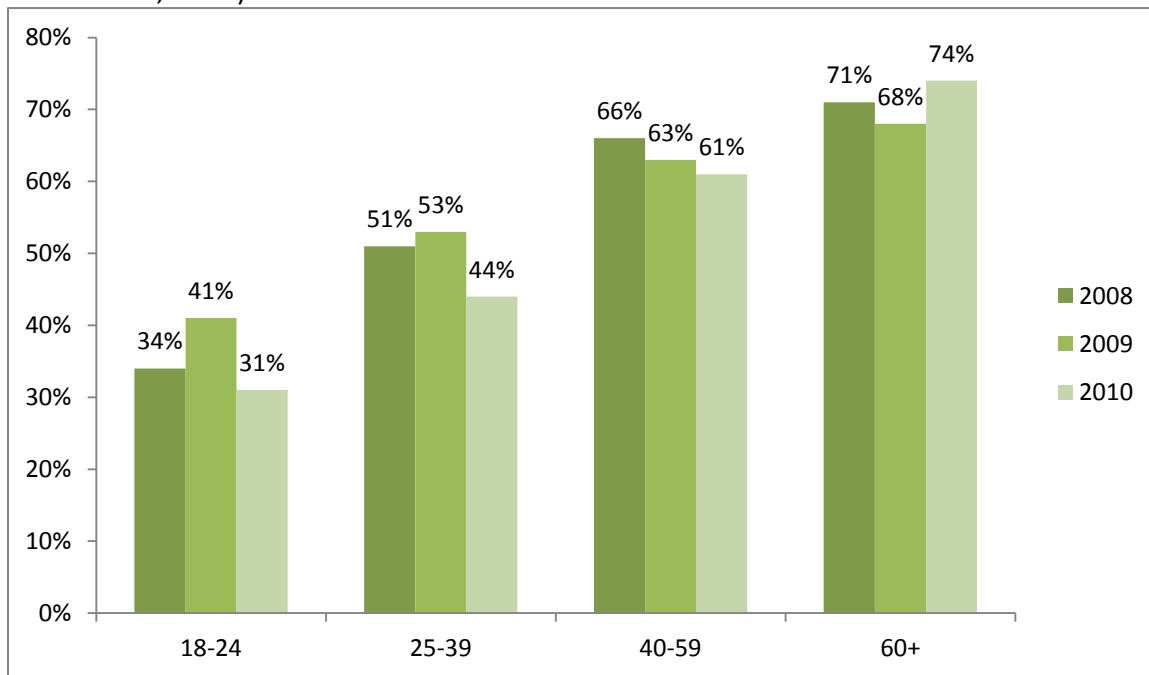
Industry Overview

There are approximately 20,000 coffee shops in the United States with combined annual revenues equaling almost \$10 billion. This industry is highly concentrated in that the top 50 companies generate 70% of total industry sales, (First Research, 2011).

Consumers

Consumers spend an average of \$2.45 for an espresso-based drink or \$1.38 for a cup of brewed coffee. The majority of Americans (65%) drink coffee at breakfast. Thirty percent report drinking coffee in between meals, while 5% say they drink it with meals other than breakfast, (Harvard School of Public Health, 2012).

The following table shows the percentage of people who drink coffee, by age, (National Coffee Association, 2010):



Success Factors

The following factors contribute to the success of coffee shops in the United States, (IBISWorld 2011):

Business expertise of operators

Business expertise is required in an industry that generates high revenue, but low margins, and has a high propensity for losses.

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Effective cost controls

Cost controls with minimal waste are important in this low margin industry, particularly related to food inputs.

Ability to franchise operations

Franchising in both the United States and overseas is now a significant component of this industry and can assist by providing necessary support to owners.

Product is sold at high-profile outlets

It is important to have high-profile locations for stores, with easy access, parking and drive-thru services for customer convenience and service.

Market research and understanding

Firms need to monitor market and consumer needs, wants and desires, particularly in relation to demand for more healthy foods.

Access to multi-skilled and flexible workforce

Firms need to have access to a good supply of skilled, casual workers to meet peak service demand periods.

Risks and Challenges

The follow are challenges that coffee shops face, (First Research, 2011):

Dependence on Healthy Economy - Specialty coffee sales depend on personal income and a strong economy. Consumers consider specialty coffee and espresso drinks affordable luxuries due to premium pricing. Spending on expensive coffee drinks may fall as disposable incomes decreases.

Industry Concentration - Starbucks operates throughout the US, and chains like Caribou and Peet's can have a strong regional presence. Independent coffee shops have been able to capitalize on the growing popularity of specialty coffee created by large companies. However, chain-saturation in some markets has forced independent coffee shops to close.

Influence of Weather - Weather can influence coffee consumption, store traffic, and supply, as consumption of coffee and hot coffee-based specialty drinks tends to decrease during warm weather. Rain or snow can also reduce store traffic and consequently sales, as can extended periods of unseasonably warm temperatures. In addition, poor conditions in grower countries can reduce or destroy a coffee crop, affecting supply.

Health Concerns - Negative publicity about caffeine and the high caloric content of some specialty drinks can reduce demand for coffee products. Coffee contains significant amounts of caffeine, and some studies linking caffeine to medical conditions can lead some consumers to

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decrease consumption. On the other hand, some studies also show medical benefits of caffeine. In addition, concerns over obesity have focused attention on certain specialty coffee drinks that exceed 500 calories. Even a temporary drop in demand based on health concerns can adversely affect sales.

Competition for Prime Retail Locations - Coffee shops compete with numerous other retail businesses, in addition to other coffee shops, to lease the best locations. Competition reduces negotiating power with landlords, and can result in higher rental costs. Because the average purchase at a coffee shop is relatively small, coffee shops depend on volume, and need to be in high traffic locations.

Opportunities

Listed below are some opportunities within the coffee shop industry, (First Research, 2011):

Product Innovation - Nontraditional drinks can generate customer excitement and seasonal offerings can help boost sales. Pumpkin Spice, Gingerbread, and Eggnog Lattes are all espresso-based drinks with unique flavors that may attract new customers. Chilled, frozen, and over-ice coffee drinks are one of the fastest-growing beverage segments, and help generate sales during warm weather. Tea-based drinks, like chai tea (tea, spices, milk, and sugar) and tea lattes, broaden appeal and offer customers something new.

Non-Coffee Sales - Coffee shops can drive incremental sales by offering complementary foods, alternative beverages, and related merchandise. Starbucks derives about 20 percent of its coffee shop sales from food, and less than 5 percent from merchandise. By providing pastries and sandwiches, companies attract customers looking for meals or snacks. T-shirts, coffee mugs, and music CDs help a company develop a unique “coffee culture.” Coffee-flavored candy and mints, most often sold at point of sale, drive impulse purchases. By selling high-end coffee and espresso brewing equipment, companies reinforce a premium quality image.

Superior Customer Service - Friendly employees and great service help coffee shops differentiate from other outlets. Companies can develop a loyal following by knowing customer names and preferred drink orders. Starbucks continuously tries to improve transaction speed by improving technology and process. Some companies use “mystery shoppers” to evaluate customer service.

Anti-Starbucks Movement - Independent coffee shops can benefit from the growing group of consumers who resent Starbucks’ domination of the industry. In some areas, a Starbucks on every corner has led to market saturation and resentment from consumers looking for variety. Some younger consumers, more interested in unique retail experiences and products, are turned off by Starbucks’ mass appeal. Anti-Starbucks customers look for independent shops

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that roast small batches of coffee, and more closely reflect the style and attitude of the local community.

Community Relations - Independent coffee shops can build a customer base by becoming informal neighborhood meeting spots. Hosting book clubs and civic events creates a regular pattern of visits for groups of customers. Companies may also donate coffee to school activities and fundraisers to enhance their image within a local market. Strong community ties help independent coffee shops become a “habit,” or regular stop, for local customers.

Social Responsibility - The sale of Fair Trade coffee attracts socially responsible customers and can enhance a company’s image. Many companies offer Fair Trade coffee – coffee purchased at a price above market value to ensure a sustainable business for growers. As a result of increased publicity on the plight of coffee farmers in developing countries, more consumers care about the countries of origin and growers’ living conditions. Imports of Fair Trade coffee into the US grew by about 70% from 2006 to 2009, according to Fair Trade USA. In addition, companies can be environmentally sensitive by using recyclable materials and encouraging the use of travel mugs.

Trends

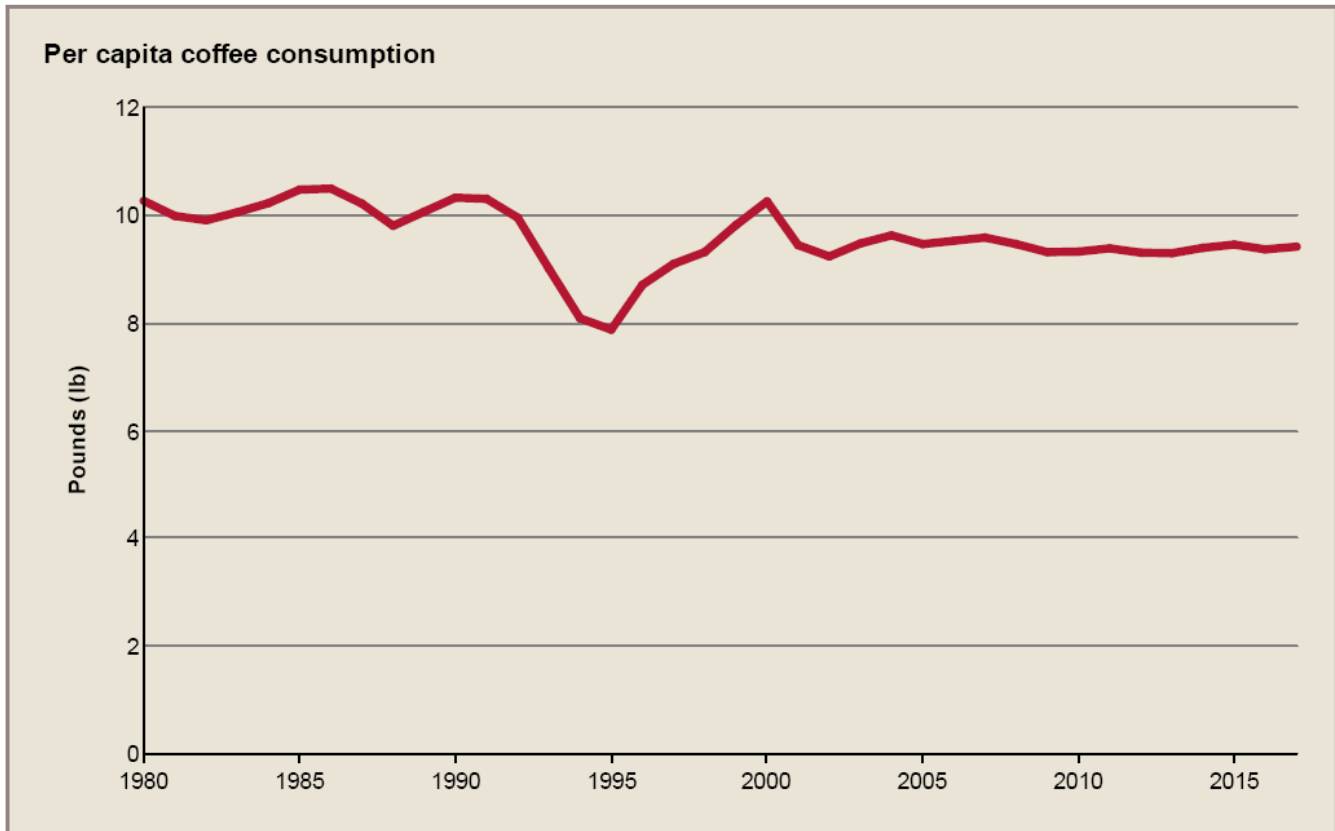
Competition has led some coffee shops to try and increase sales of whole and ground coffee beans, for both consumer and commercial use. Many companies retail beans through grocery stores, specialty food stores, and the internet. Some examples are Starbucks and Dunkin Donuts. Companies may sell beans to commercial customers like foodservice operators, airlines and restaurants. Increased availability of products through alternative channels helps build brand awareness and often drives consumers into coffee shops.

About 85 percent of coffee drinkers make their own coffee at home and consumers have more ways to brew their own high-quality coffee and espresso drinks. Spending on coffeemakers and espresso/cappuccino machines for home use costing more than \$100 increased 42 percent between 2006 and 2007. In addition, several large food companies offer instant versions of specialty drinks, like cappuccino. The expansion in the home-brew market can impact the revenues of coffee shops as fewer consumers are buying coffee there, (First Research, 2011).

The table below shows the average per capita, annual consumption of coffee in pounds. Consumption has fallen slightly in the last 30 years, but is projected to remain relatively stable over the next five year, (IBISWorld, 2011).

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Financial Information

The following financial benchmark information is for coffee shops in the US. The data is based on the financial statements of 18,832 companies, 16,138 of which are small businesses. A small business is defined as having annual sales less than \$ 1 million (First Research, 2011).

Financial Ratios		
	Aggregate	Small Company
Quick Ratio	.90	.85
Current Ratio	1.28	1.22
Current Liabilities to Net Worth	26.5%	33.7%
Current Liabilities to Inventory	x5.15	x5.19
Total Liabilities to Net Worth	x.98	x1.14
Fixed Assets to Net Worth	x1.29	x1.61
Collection Period	8 days	5 days
Inventory Turnover	x16.94	x19.61
Assets to Sales	34.8%	27.9%
Working Capital to Sales	1.3%	.9%

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Accounts Payable to Sales	2.3%	2.0%
Pre-Tax Return on Sales	.9%	.8%
Pre-Tax Return on Assets	2.6%	3.0%
Pre-Tax Return on Net Worth	5.2%	7.3%
Interest Coverage	x1.24	x1.24

Resources

1. First Research, Inc. 2007, *“Industry Profile: Coffee Shops.”* Austin, TX: First Research. November 21, 2011. <http://www.firstresearch.com>.
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3. IBISWorld Pty Ltd., *“Coffee and Snack Shops in the US.”* New York: IBISWorld. October 2011. <http://www.ibisworld.com>.
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5. National Coffee Association’s *“2010 National Coffee Drinking Trends Study.”* (Accessed January 10, 2012). <http://www.ncausa.org/i4a/pages/index.cfm?pageid=731>.
6. ESRI Business Analyst Online, *“Washington State” Retail Goods & Services Expenditures,* (Accessed May 27, 2011). http://bao.esri.com/?from+bao_mainpg.