

COFFEE WARS: STARBUCKS VS. MCDONALD'S

THE PURVEYOR OF BURGERS IS GOING UPSCALE, TREADING ON TURF THAT THE COFFEE TITAN HAS TROLLED FOR YEARS. WHICH COMPANY WILL PREVAIL? AND WHAT'S THE EFFECT ON CONSUMERS?

Would you like some fries with that cinnamon dolce latte? OK, you probably won't hear that question any time soon. But in an odd twist in the evolutionary path of quick-serve eateries, McDonald's and Starbucks are looking more alike every day. It's a trend that's going to continue, for a few simple reasons. With a McDonald's or a Starbucks just about everywhere you look, both companies are running out of room to roam.



Who's winning the coffee wars? Starbucks was once expanding so rapidly that comedians joked it would be opening new coffee shops inside the bathrooms of existing outlets. The Seattle company plans to launch just 100 U.S. stores this year, though. And in the cutthroat world of fast food, McDonald's needs to distance itself from powerful rivals like Burger King and Subway.

This competitive dynamic has the queen of premium coffee and the king of fast food poaching each others' customers in a low-key but persistent battle. Each is taking ideas from the other's playbook on how to please customers and boost the bottom line. Call it the battle of the fries versus Frappuccinos. The double cheeseburger versus the double espresso. Or the Golden Arches versus the green siren. Whatever you name it, it's real, even if neither company admits it, and even if it's more a series of limited campaigns than an outright food fight.

I'll show you why, in a minute, since you might not believe it because these companies are so different. After all, Starbucks and McDonald's have distinct customer bases -- one more affluent, the other more price sensitive. Each fan base is loyal, so there are limits to how much tinkering either of these iconic eateries can get away with. But there's plenty of middle ground -- occupied by a customer who is happy to frequent these two chains and all kinds of other fast-food joints.

So who is going to win? It would seem that McDonald's has the most to gain. And it's easier for it to become more like Starbucks without damaging its brand than vice versa. Plus, profit margins are higher for coffee than for burgers and fries. So, the benefit to the bottom line in any victory in the coffee wars favors McDonald's. Make no mistake, though; Starbucks has a lot to gain as it imitates what works at McDonald's. The other big winner just might be the consumer -- who gets higher-quality food and drinks and new amenities at McDonald's, and a bigger variety of quality food to nosh on while surfing the Internet at Starbucks.

Early on, burgers and fries, and later breakfast meals were strengths for McDonald's. Drinks were an afterthought. It took a while, but the chain noticed the big profits Starbucks was raking in from coffee sales. McDonald's knew it could never get away with \$5 coffee drinks. Well aware of its customer base, McDonald's is "always keeping an ever-vigilant eye on everyday affordability, which is the most important thing for our consumers," CEO Jim Skinner said during the company's most recent conference call with shareholders. "They get pinched everywhere," Skinner added. "They should not suffer the same fate at McDonald's."

But, taking a page from the Starbucks playbook, McDonald's has rolled out premium coffee. It's been a big hit, and it is growing by leaps and bounds. During the last quarter, sales of "specialty coffees" increased 17% from a year earlier. "We believe McDonald's could evolve into Starbucks' fiercest rival in the specialty coffee segment," says analyst R.J. Hottovy, who covers both companies for Morningstar.

This puts Starbucks in a quandary. It's got to be careful not to cheapen its brand, yet it needs to respond to this challenge from McDonald's. So far, Starbucks has finessed the matter well. It went after McDonald's coffee customers with a rollout of its premium coffee brand Seattle's Best Coffee at more than 30,000 quick-service competitors of McDonald's, such as Subway. This gives the company exposure to this space without putting the Starbucks name into the fray. By stealthily moving into this part of the market, Starbucks looks more like McDonald's, at least behind the scenes, without diluting the premium aspects of its name in the eyes of the public. Job well done.

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ESSAY QUESTION

Please type your response to the following question in WORD and staple your answer to the back of this sheet. Your response should be at least **200 words** in length.

1. Starbucks and McDonald's are so different. So how exactly are they competitors? What is McDonald's doing to compete with Starbucks? What is Starbucks doing to compete with McDonalds? Why do both brands need to be very careful in HOW they choose to compete with each other? Who are the winners and losers in this battle?
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RATIO ANALYSIS (use your "cheat sheet" and refer to BF 4.4 for help on these ratios)

Use the financial statements at the end of this packet to calculate the following ratios. You should hand write your answers to the problems in the space provided.

1. Calculate LIQUIDITY RATIOS for each company. CIRCLE the company with the better ratio.

Starbucks	McDonald's
Current Ratio	
Quick Ratio	
Working Capital	

2. Calculate ASSET MANAGEMENT RATIOS for each company. CIRCLE the company with the better ratio.

Starbucks	McDonald's
Inventory Turnover Ratio	
Total Asset Turnover Ratio	
Accounts Receivable Turnover Ratio	

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3. Calculate DEBT MANAGEMENT RATIOS for each company. CIRCLE the company with the better ratio.

Starbucks	McDonald's
Debt Ratio	
Times-Interest Earned Ratio	

4. Calculate PROFITABILITY RATIOS for each company. CIRCLE the company with the better ratio.

Starbucks	McDonald's
Profit Margin on Sales Ratio	
Return on Total Assets Ratio	
Return on Equity Ratio	

5. Calculate MARKET PERFORMANCE RATIOS for each company. CIRCLE the company with the better ratio.

Starbucks	McDonald's
Earnings Per Share	
Price to Earnings Ratio	
Market to Book Ratio	

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McDonald's Financial Statements

(all numbers are in thousands)

INCOME STATEMENT

Total Revenue	24,074,600 ◀
Cost of Revenue	14,437,300
Gross Profit	9,637,300
Operating Expenses	
Research Development	-
Selling General and Administrative	2,135,100
Non Recurring	29,100
Others	-
Total Operating Expenses	-
Operating Income or Loss	7,473,100 ◀
Income from Continuing Operations	
Total Other Income/Expenses Net	(21,900)
Earnings Before Interest And Taxes	7,451,200
Interest Expense	450,900 ◀
Income Before Tax	7,000,300
Income Tax Expense	2,054,000
Minority Interest	-
Net Income From Continuing Ops	4,946,300
Non-recurring Events	
Discontinued Operations	-
Extraordinary Items	-
Effect Of Accounting Changes	-
Other Items	-
Net Income	4,946,300 ◀

Number of Shares Issued	1,020,000 ◀
Market Stock Price	\$100.32 ◀

BALANCE SHEET

Assets	
Current Assets	
Cash And Cash Equivalents	2,387,000
Short Term Investments	-
Net Receivables	1,179,100 ◀
Inventory	109,900 ◀
Other Current Assets	692,500
Total Current Assets	4,368,500 ◀
Long Term Investments	1,335,300
Property Plant and Equipment	22,060,600
Goodwill	2,586,100
Intangible Assets	-
Accumulated Amortization	-
Other Assets	1,624,700
Deferred Long Term Asset Charges	-
Total Assets	31,975,200 ◀
Liabilities	
Current Liabilities	
Accounts Payable	2,916,400
Short/Current Long Term Debt	8,300 ◀
Other Current Liabilities	-
Total Current Liabilities	2,924,700 ◀
Long Term Debt	11,497,000 ◀
Other Liabilities	1,586,900
Deferred Long Term Liability Charges	1,332,400
Minority Interest	-
Negative Goodwill	-
Total Liabilities	17,341,000 ◀
Stockholders' Equity	
Misc Stocks Options Warrants	-
Redeemable Preferred Stock	-
Preferred Stock	-
Common Stock	16,600
Retained Earnings	33,811,700
Treasury Stock	(25,143,400)
Capital Surplus	5,196,400
Other Stockholder Equity	752,900
Total Stockholder Equity	14,634,200 ◀

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Starbucks Financial Statements

(all numbers are in thousands)

INCOME STATEMENT

Total Revenue	11,700,400	◀
Cost of Revenue	4,949,300	
Gross Profit	6,751,100	
Operating Expenses		
Research Development	-	
Selling General and Administrative	4,703,200	
Non Recurring	-	
Others	523,300	
Total Operating Expenses	-	
Operating Income or Loss	1,524,600	◀
Income from Continuing Operations		
Total Other Income/Expenses Net	146,100	
Earnings Before Interest And Taxes	1,844,400	
Interest Expense	33,300	◀
Income Before Tax	1,811,100	
Income Tax Expense	563,100	
Minority Interest	(2,300)	
Net Income From Continuing Ops	1,419,400	
Non-recurring Events		
Discontinued Operations	-	
Extraordinary Items	-	
Effect Of Accounting Changes	-	
Other Items	-	
Net Income	1,245,700	◀

Number of Shares Issued	753,400	◀
Market Stock Price	\$48.30	◀

BALANCE SHEET

Assets		
Current Assets		
Cash And Cash Equivalents	1,148,100	
Short Term Investments	902,600	
Net Receivables	616,900	◀
Inventory	965,800	◀
Other Current Assets	161,500	
Total Current Assets	3,794,900	◀
Long Term Investments	479,300	
Property Plant and Equipment	2,355,000	
Goodwill	321,600	
Intangible Assets	111,900	
Accumulated Amortization	-	
Other Assets	297,700	
Deferred Long Term Asset Charges	-	
Total Assets	7,360,400	◀
Liabilities		
Current Liabilities		
Accounts Payable	1,626,500	
Short/Current Long Term Debt	-	◀
Other Current Liabilities	449,300	
Total Current Liabilities	2,075,800	◀
Long Term Debt	549,500	◀
Other Liabilities	347,800	
Deferred Long Term Liability Charges	-	
Minority Interest	2,400	
Negative Goodwill	-	
Total Liabilities	2,975,500	◀
Stockholders' Equity		
Misc Stocks Options Warrants	-	
Redeemable Preferred Stock	-	
Preferred Stock	-	
Common Stock	700	
Retained Earnings	4,297,400	
Treasury Stock	-	
Capital Surplus	40,500	
Other Stockholder Equity	46,300	
Total Stockholder Equity	4,384,900	◀