

## Kofi or Coffee – Starbucks Enters the Indian Market

*Sambhavi Lakshminarayanan, City University of New York*

*Evelyn Maggio, City University of New York*

*Simon Best, City University of New York*

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### Introduction

Avani Davda apologized as an employee cleaned up the mess she had made with the coffee machine (Vijayaraghavan, 2015). But brewing errors were the least of Avani's problems. As CEO of Tata-Starbucks, and the youngest chief executive in the sprawling Tata conglomerate, there was a lot she had to learn quickly. The most immediate need was to steer current stores to profitability in a crowded and difficult marketplace. Soon thereafter, Avani would have to implement expansion strategies as well.

Tata-Starbucks was an exciting, high-stakes endeavor, a joint venture between Starbucks and Tata Global Beverages (TGB). In its quest for growth opportunities around the globe, Starbucks had been eyeing India for some time. After all, India was the world's second most populous country, with potential for significant international revenue. For TGB, the joint venture was an opportunity to enter the Indian retail market. TGB had been under pressure from its investors to improve its performance and Tata-Starbucks could be the way for it to bump up revenues and increase profit margins. If successful, the joint venture would deliver welcome results for both these giants.

India, with its growing population of more than one billion people, held the promise several million new customers. On the downside, the picky, tradition-bound, and notoriously price-sensitive Indians were tough customers (Thomas, 2014). A few international coffee chains had previously entered the market, only to withdraw, partially or completely, in defeat. Meanwhile, a local coffee chain had survived through a combination of dogged persistence and nimble positioning, and it would be a tough rival.

The pressure was on, and the day of reckoning was getting closer for Avani. The venture's launch in Mumbai and initial store openings in other major cities had been met with excitement by customers. But these locations were in high-demand areas and may simply have been low-hanging fruit. Future growth would not be that easy. Avani would have to expand into less predictable areas and build a loyal customer base. Competitors would step up their efforts and investors their demands. Avani knew the time had come to double down on positioning and location strategies. What she had to decide soon was "how."

### Did Starbucks “Have” to Enter India?

Since first setting up shop in Seattle in 1971, Starbucks had expanded to more than 20,000 retail stores in 65 countries and grown into an iconic global brand ([www.starbucks.com](http://www.starbucks.com)). Starbucks had also diversified beyond its original stand-alone store format in several ways: through partnering, placement in highway rest areas and distributing product via supermarkets and grocery stores. After dominating several market categories in the United States, including that of “Coffee and Snack Shops” (Lazlich, 2013), Starbucks was now on the lookout for new avenues for growth.

Starbucks’ annual report indicated the company anticipated its overall sales and growth in the near future to come primarily from the Americas and the China-Asia Pacific region (Starbucks, 2014). The U.S. market had been Starbucks’ main source of revenue from the start. Though historically a reliable market, the Americas did not show potential for rapid growth in the future. Some data showed that coffee drinking might be declining overall in the U.S. (*Fortune*, 2015), while other data indicated that sales of “gourmet” coffee had increased during the same time period. In the gourmet category, the primary factor of interest to Starbucks was the increasing popularity of at-home gourmet coffee brewing rather than in-store consumption (Beverage Industry, 2014). Overall sales growth had stalled in the Europe and Middle East region; however, the China Asia Pacific region had recorded sales increases at almost double-digit rates.

India, the second biggest market in Asia, so far remained untapped. Starbucks had considered building a presence there off and on for years. Eight years ago Starbucks had planned to enter India, but the Indian government had insisted on compliance with its policy limiting ownership to less than 51%. At that time, Starbucks had announced that it would put entry plans on hold indefinitely (David, 2007). However, India had continued to be an irresistible prize. Now it finally appeared that Starbucks would be able to satisfy current governmental conditions.

The government of India had traditionally imposed strict restrictions on foreign companies, particularly in the retail sector. For instance, for many years, ownership by foreign companies in joint ventures had been limited to 50%. This policy had effectively held back giant retailers such as Walmart, which had been constrained to wholesale selling. Walmart had even considered complete withdrawal. Only recently had the policy been eased to allow for a higher percentage of foreign ownership, if the store sold a “single brand” (Bajaj, 2012, p. 63). Food retailers had dealt with such restrictions quite successfully and had survived for several years. For instance, Domino’s and Dunkin Donuts had both entered via partnerships with a local franchise owner named Jubilant FoodWorks Ltd. (Rana, 2014). McDonald’s had entered through joint ventures with two different local businesses (InvestinIndia, 2011).

The Indian marketplace gave cause for both optimism and concern. India’s Gross Domestic Product was projected to grow by about 8%. At the same time, inflation was a continuing issue for consumers. Inflation had been as high as 10% at certain periods in the past. However, more recently, it had stabilized at around 5%, and it was projected to continue at that rate (*Business Monitor*, 2015). India had attracted large amounts of foreign direct investment in the last few decades. Outsourcing and technology-related sectors had contributed significantly to

employment and growth of a middle class. There had been an increase in the number of young adults with disposable income and aspirations. On the flip side, a combination of poor infrastructure, government restrictions, and wage increases had led some global companies to seek cheaper alternatives elsewhere, with a resulting impact on the economy. Some of India's challenges, particularly those involving infrastructure, were typical of developing countries. For instance, electricity supply was woefully inadequate to meet a growing commercial and residential demand. Reportedly, up to 50% of manufacturers experienced weekly power shutdowns of at least five hours (*Economist*, 2015).

On the supply side, the retail sector had traditionally been unorganized, consisting mostly of small, proprietary businesses with unreliable supply chains. However, the more recent entry of big corporations, both domestic and international, was driving the retail sector towards more uniformity and a certain level of vertical integration. This sector, in which Tata-Starbucks would be situated, delivered aspiration value as well as necessary products and was becoming easier to navigate.

Internal demand was influenced both by the sheer size of the population, which trended young, as well as by employment patterns. Economic and demographic forecasts in *Business Monitor International* (2014, p. 1) noted that major urban areas in India were expected to stabilize in size, and that growth would shift to smaller, tier 2 cities. This report further noted that general household spending in higher income groups was projected to increase by about 10% annually over the next seven years.

Culture, social practices, and personal habits were critical factors to consider for businesses like Starbucks. Old traditions could be hard to change. In particular, family played an outsized role in Indian society. However, the past decade or so had witnessed some social changes, such as an increasing trend of socializing with co-workers and aspirational spending. Such changes were primarily in the technology and outsourcing sectors, where employees were typically young and more open to change.

Finally, a challenge that specifically affected Starbucks was that coffee was not a beverage of choice for most people in the country. Although the general populace did consume hot beverages, primarily at home, the drink of choice for the majority was tea. Those in the business of selling coffee had been trying to gain traction, but tea drinking was so ingrained that 70% of the nearly one million metric tons of tea produced in the country was consumed by its own people. The Ministry of Commerce had refused to promote either beverage over the other, in an effort to avoid hurting either industry (Ghosh, 2013).

Despite all these known and predictable difficulties that lay ahead, Starbucks decided to take the plunge and enter the Indian market.

### **A Joint Venture with a Beverage Giant**

Tata Global Beverages Limited (<http://www.tataglobalbeverages.com/>) was a powerhouse in the Indian business world. It was part of the Tata Group of Companies, a sprawling conglomerate

that included Tata Consulting Services, one of the world's biggest business and technology consulting firms. Of late, TGB had been facing challenges; the stock was perceived as underperforming, and investors had been putting pressure on the company to improve its overall performance.

The Tata-Starbucks venture was an opportunity for TGB to address the issues of weak sales and the (typical) lower margins of wholesaling. Starbucks' strong brand name and deep experience would undoubtedly help in this effort. The partnership's success was not assured, but it appeared that both parent companies were prepared to take on the challenge of retailing in a tough market (Sagar, 2013). The initial strategy would be one of rapid expansion, not necessarily tied to profit goals. Aggressive expansion in areas identified as "emerging markets" was a tactic straight out of Starbucks' standard playbook; it had deployed a similar strategy in China (Vijayaraghavan, 2015). Tata Consulting Services would provide support in the venture's use of technology.

TGB was primarily a wholesaler of non-alcoholic beverages, engaged in "the trading, production, and distribution of tea, coffee, and water" with revenues of around \$1.2 billion (Tata Global Beverages, 2015). Most of TGB's branded business operations were in India, with some extensions to Europe, the United States, Canada and Australia. TGB owned well-established local Tata brands and also a few iconic international brands such as Tetley Tea, from the U.K., and Eight O'Clock Coffee, from the U.S. Apart from its wholesale operations, TGB also maintained plantations in India and Sri Lanka and ran extraction businesses in India, the U.S., and China (Tata Global Beverages, 2015).

TGB's sales portfolio was dominated by tea, which contributed to three-quarters of its revenue. Coffee was definitely part of the portfolio, but coffee sales had been weak (Agarwal, 2014). TGB's portfolio also included bottled water, a strong product in India that had experienced growth over the last few years.

Products sold at Tata-Starbucks were mainly to be sourced by TGB. The company procured its teas from "around the world." TGB's own "Himalayan" brand water, sourced from the mountain range of that name, would be the only bottled water sold in Tata-Starbucks stores (Tata Global Beverages, 2015). For Starbucks, one feature that differentiated the venture in India from that in other countries was coffee sourcing. Indian government policies made it very expensive to import coffee, so the best option was to source coffee in India via TGB. Coffee beans were predominantly grown in the Southern state of Karnataka. Historically, growers had consisted of many small-holding farmers. However, some years back, there had been a crisis in Indian coffee farming, related to weather and politico-economic factors. The government had intervened to de-regulate the sector, diluting the tight control exercised by the "Coffee Board" and allowing private companies to move in (Sridhar, 2013, p 22-23). Seizing the opportunity available then, Tata had entered the business of growing coffee beans. Now TGB and Starbucks were planning not only to use those coffee beans, but also to further extend their reach into the supply chain by building their own roasting facility (Starbucks, 2015).

With such local sourcing Tata-Starbucks could reflect the tastes of local customers as well as gain approval of the community by framing itself as a "domestic" retailer, both of which could be important advantages for the venture (Morrell, 2010).

### **Kofi, Kapi, and Chai - Just Not in a Café**

Contrary to conventional wisdom, consumption of hot beverages was quite prevalent in India, even though the climate was itself hot. Coffee was referred to variously as kapi in South India and kofi elsewhere, and tea as “chai” in most parts of the country. However, beverage consumption in India was lower than in many other countries, particularly the United States.

Starbucks was not the only, or even the first, chain to eye the Indian market. The USDA (Gain Report, 2014) identified several beverage retailers in India, including: Café Coffee Day, Javagreen and Qwiky’s (all Indian); Barista Lavazza and Pascucci’s (both from Italy); Costa Coffee (Britain); Gloria Jean’s (Australia); and McDonald’s, Dunkin Donuts, Coffee Bean & Tea Leaf, and Starbucks (all from the U.S.). According to this report, the number of Indian cafés was expected to grow, but the pace of that growth appeared to be slowing, and “demand for coffee from the sector was limited.” Coffee production in the country was expected to remain constant. The report noted that per capita domestic consumption was low. Some analysts viewed coffee as “a more urban, middle-class drink” (Nayak, 2012) or one popular among “intellectuals, South Indian traditionalists, and five-star coffee shop visitors” (Agrawal, 2009, p. 253).

For both coffee and tea, the strong cultural tradition was to drink at home, both for personal consumption, and also when offered as a ubiquitous gesture of hospitality to guests. Outside of the home, consumption was usually from “chaiwallas,” “kapi kadais,” and other small businesses selling at the lowest price points. Coffee was mainly consumed in the North as instant coffee at home. In the South, it was brewed in a “filter” and served in a traditional “dabra-tumbler” (Trip Advisor, 2016), which served the purpose of both a cup and a saucer. Drinking from a Starbucks mug (Starbucks Mugs) would thus be a big change. In contrast to South India, which accounted for 70% of the country’s coffee consumption, tea was the beverage of choice in North India (Nayak, 2012). Overall, tea was a common beverage in both the rural and urban parts of the country, barring certain portions in the South.

Consumption patterns had changed in some segments of society, and these changes related to social changes resulting from the advent of outsourcing by international companies into India. Most employees of such firms, typically working in the field of technology, were young, willing to spend money and comfortable in a different, especially Western, culture. They were amenable to drinking coffee and tea outside the home and paying more than the absolute minimum for it. This marked the beginnings of “café habits,” if not quite a “café culture,” and thus offered hope and promise for businesses like Tata-Starbucks.

### **Formidable Rivals**

The competitive landscape was crowded. Starbucks saw old, familiar hometown rivals such as McDonald’s and Dunkin Donuts, along with a few new ones. McDonald’s had entered India in two different 50/50 joint ventures, one with Hardcastle Restaurants, and the other with Connaught Plaza Restaurants. Some years later, McDonald’s had converted its part-ownership in Hardcastle to a franchise relationship (InvestinIndia, 2011). McDonald’s in India had mainly



focused on food, altering its signature burgers to suit local tastes by making them spicier, displaying cultural sensitivity by not using beef, and trying to offer a different dining experience.

Dunkin Donuts had entered through the same local franchiser that had brought Domino's into India. However, Dunkin Donuts had struggled to find an identity, experimenting with flavors likely to appeal to Indian tastes, such as mango. The biggest challenge it faced was the difference in consumption habits (Rana, 2014). Whereas Dunkin Donuts had significant breakfast sales in the United States, Indian breakfast sales were non-existent. Consumers in India simply did not get "breakfast-to-go," nor did they purchase sweet foods in the morning. Indeed, donuts were viewed as a dessert item, to be consumed for special occasions. As a result, Dunkin Donuts redesigned its menu offerings to include sandwiches and burgers, and it renamed the stores as "Dunkin Donuts and More" (Rana, 2014).

The challenges Dunkin Donuts faced were surprising, given that its franchiser Jubilant Foodworks had been wildly successful with Domino's. Jubilant Foodworks had successfully introduced a completely unfamiliar food item (pizza), made in an unfamiliar manner (baking), to wide portions of the population. It had successfully penetrated not only major urban areas, but also less "Westernized" ones. Domino's reportedly sold more pizza in India than in any other country, second only to the United States (Rai, 2015, p. 54). To do so, the company had to perform a delicate balancing act between delivering something new and "cool," while keeping the old and familiar. For instance, some locations included spacious seating to accommodate India's strong cultural tradition of multi-generation, family-style dining when eating out. Thus, Domino's had re-engineered its product, changed its business model and altered its toppings, all without over-localizing its entire offering.

Some international rivals in the coffee café shop category, who had initially targeted the high end of the Indian market, had either left or re-formulated their strategy. Barista had closed low-performing stores and experienced five changes in ownership, De Bella had lowered prices, and Costa Coffee was reportedly seeking a new partner (Pinto, 2014).

Possibly the strongest rival in the coffee shop category was Café Coffee Day (CCD), a local chain that had been in existence for almost two decades. It had started as an "internet café," where customers paid for internet connection service and were provided free coffee. CCD's founder, V. G. Siddharth, came from a coffee-growing family and now owned numerous coffee estates (Agrawal, 2009, p. 252). Some years after launching CCD, Mr. Siddharth had decided to re-strategize completely after identifying two key limitations to growth: first, that his stores were being perceived as only "South Indian," and second that most of his customers were in the 15-30-year-old age range (Agrawal, 2009, p.255). The resulting change was a "multi-channel, multi-format business" (Mishra, 2013, p. 163, p. 168). CCD had about 1,500 retail café outlets, all company owned. Along with cafes, the business included the following retail formats:

- Coffee Day Xpress, which focused on beverages;
- Coffee Day Lounge, which was geared towards families;
- Coffee Day Square, which sold high-end, single-origin coffees;
- Coffee Day Fresh & Ground, which was located near grocery stores and sold beans;
- Coffee Day Beverages, which handled vending machine sales; and

- Coffee Day exports.

In addition, CCD had expanded its retail operations overseas to East Europe. It was a vertically integrated enterprise. As it owned curing and roasting facilities. CCD had also diversified into non-beverage areas, such as hospitality and infrastructure development in technology companies. Most recently, it was reported that CCD was planning a \$1 billion IPO (Alexander & Narayan, 2014).

### **Market Entry Strategy: Entering with a Lower-Priced Bang**

Two critical factors in any retailer's strategy in India had always been pricing and location.

The Indian market was well-known to be value conscious and price sensitive. High initial sales could sometimes be driven by consumer curiosity, brand familiarity, and aspirational desires. Yet these were unlikely to be sustained without a strong value proposition to consumers. Inflation would pose a further hurdle, with the likely possibility that a drop in purchasing power would result in consumers being priced out of the market.

For Tata-Starbucks, pricing, immediate profitability and long-term success were inextricably linked. Setting prices low to deliver value and to keep competitors out would mean sacrificing margins. However, setting prices too high could lead to decreasing foot traffic and reduced sales, and thus directly lead to market underperformance.

Tata-Starbucks entered the market with coffee priced in between its competitors high and low points (Vats, 2012). For instance, Tata-Starbucks priced its small cappuccino uniformly at Rs. 95 (around \$2). This was just a little lower than pricing by Costa Coffee, but higher than the Rs. 60 (about \$1.20) at Café Coffee Day (Arora, 2013). Interestingly, Starbucks' product pricing in India was considerably lower, by almost 50%, when compared to its pricing in other parts of the world, even elsewhere in Asia. For instance, in Beijing, China, a small cappuccino was priced at around \$4.40 (MacIsaac, 2013).

Several competitors in India had experimented with differential pricing. In contrast to these high-end chains, Starbucks CEO Howard Schultz announced that pricing would be uniform all over India, regardless of location. Interestingly, some high-priced chains then announced that they would not follow Starbucks' lead, but instead would retain differential pricing (Press Trust of India, 2012).

Location was another key factor to consider. The first Tata-Starbucks store opened in Mumbai. Reportedly, a seed amount of \$80 million had been set aside for rolling out new stores (Bailey, 2014). Within two years of launching, there were more than 50 stores spread across six cities. The locations were all in major metropolitan areas, mostly in Southern India. These areas included: the city of Mumbai, the commercial hub of India; New Delhi, the capital city; Hyderabad and Pune, both mid-sized cities in the middle of the country, each of which boasted a strong presence of high-tech companies; Bangaluru, the iconic high-tech city mentioned in the book "The World is Flat;" and Chennai, a Southern city with very high per capita coffee consumption. Each of those cities had some combination of three factors: substantial numbers of

coffee drinkers, groups with high levels of disposable income, and a significant number of “Westernized” consumers.

At first glance, it seemed that only major metropolitan areas might have consumers with the means and disposition to buy Tata-Starbucks’ products. Geographic limitations were indicated by past data showing that coffee drinkers were mostly found in the South and tea drinkers in the North. However, other ventures had shown that such assumptions could be turned upside down by product positioning and an appropriate pricing strategy. For instance, Domino’s had successfully positioned itself as an affordable special dining choice for the family, rather than its U.S. positioning as a fast and convenient food delivery business. Similarly, an innovative strategy could open smaller urban areas and new groups of customers for Tata-Starbucks.

In its annual financial reports following the launch of Tata-Starbucks, TGB did not report revenues separately for the venture, merely stating that consumer response had been good and there was a continuing focus on expansion (Tata Global Beverages, 2015). Simultaneously, retail consultants noted that many retail coffee sellers had faced setbacks in sustaining sales in the Indian market (Vijayaraghavan, 2015). Thus, even as reported sales per store at Tata-Starbucks exceeded those of its rivals (Sagar, 2014), CEO Davda knew that success would not come that easily.

### **The Road Ahead**

Going forward, CEO Avani Davda faced two tough challenges. The first was expansion beyond major cities. The second was avoiding a profit-draining price war with rivals.

Avani would have to choose whether to stay in the big metropolitan areas or venture into tier 2 zones. Profitability would soon become a concern. There were lessons to be learned from the experiences of other gourmet coffee chains. An added unknown was CCD. She would have to anticipate, plan for, and respond to CCD’s moves.

Many questions were swirling about the future of Tata-Starbucks. Was the entry-level price point strategy sustainable? Were Starbucks’ market adaptation initiatives working? Could Starbucks position itself in the Indian market well enough to attract and sustain, if not grow, a critical mass of customers willing to pay a premium price for its products? The company had indeed achieved initial market penetration. Avani Davda needed to summon all the skills she had learned from her prior Tata experience and mentoring, combined with her reading of the current environment, to craft a successful strategy and navigate the road ahead. This would determine whether Starbucks would renew its commitment to the Indian market, or follow some of its rivals in pulling out altogether.



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