

Starbucks Fruit/Coffee Smoothies

Starbucks is evaluating the launch of a new line of premium coffee-based fruit smoothies. Over the past year, the company has invested \$1.5 million in research and development to create and test smoothie recipes and equipment. Consumer survey data indicates that strawberry banana and mango pineapple are the most popular smoothie flavors with customers and they plan to include these flavors at launch. But now it is time to decide to go forward (or not) with the new product launch.

The estimated fixed costs to launch the smoothies across all stores include \$12.2 million for new equipment for in-store smoothie production, \$1.8 million for updated menu boards and in-store marketing displays, and \$3.3 million to initially train employees on smoothie preparation procedures and recipes.

Initially, Starbucks plans to only offer a 24 oz size, which is priced at \$5.90. To promote the new product, Starbucks will give customers free 95 cent discount coupons (approx. 16%) to use for the first 6 months after launch. The coupons will be easily available online and in-store, so it is expected that virtually all purchases will use the coupon during the promotional period.

The variable cost is projected to be on average \$1.76 for each 24 oz smoothie. Keeping health-conscious consumers in mind, Starbucks has designed these smoothies with calorie counts that range from 210 to 350 per 24 oz, depending on ingredients. Based on food costs of comparable smoothie products, Starbucks estimates a 70% contribution margin.

Industry reports suggest an estimated market demand of 65 million premium coffee-based smoothies per year across the café and coffee shop segment.

1. What is Starbucks fruit/coffee smoothie product's contribution margin as a percentage after accounting for (or netting out) variable marketing expenses, such as commissions (this is the relevant contribution margin % we should use for marketing breakeven analysis)? **Net Contribution Margin % = 70% - 16% = 54% (54.07%)**
2. Based on that margin, what is Starbucks's expected margin per customer in dollars?
 $\$5.90 \times 54\% = \3.19 or $\text{Selling Price} - \text{COGS} - \text{Variable Marketing Expenses}$, $\$5.90 - \$1.75 - \$0.95 = \3.20
3. What are the total relevant fixed costs associated with the project? **$\$12.2 \text{ million} + \$1.8 \text{ million} + \$3.3 \text{ million} = \17.3 million**
4. How many units do we need to sell in order to breakeven? **$17.3 \text{ million} / 3.19 = 5,423,197$ or $17.3 \text{ million} / 3.20 = 5,406,250$**
5. At what dollar volume in sales will Starbucks breakeven on the new project? **$\$17.3 \text{ million (Total Fixed Costs)} / .5407 = \$31,995,561$ or $5,423,197 \text{ b/e units} \times \$5.90 = \$31,996,862$**
6. What is their anticipated breakeven market share of in this new market (that is...how big does their share of this new market need to be in order to breakeven on the project)?
 $5,423,197 / 65,000,000 = 8.3\% \text{ share}$
7. Starbucks wants to know how many units they will have to sell in order to generate at least \$2,000,000 in profitability? **$17.3 + 2 = \$19.3 \text{ million} / \$3.20 = 6,031,250$**

8. Starbucks corporate management requires all projects to generate at least 15% profit margins. What dollar volume in sales will the fruit/coffee smoothies need to hit in order to generate a 15% profit margin on the project? $\$17.3\text{million}/.39(.54-.15)= \$44,358,974$

Starbucks Smoothie Income Statement		
Revenue	\$44,359,000	
Variable costs		
COGS	\$13,307,700	(30% of revenue)
Coupon Redemption	\$7,097,440	(16% of revenue)
Total variable costs	\$20,405,140	
Contribution margin	\$23,953,860	(54% of revenue)
Fixed costs		
Equipment	\$12,200,000	
Marketing displays	\$1,800,000	
Training	\$3,300,000	
Total fixed costs	\$17,300,000	(39% of revenue)
Profit	\$6,653,860	(15% of revenue)