Starbucks in Britain

A loss-making machine

Why one of Starbucks' divisions in a coffee-loving country is so unprofitable

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COFFEE shops are among the most profitable parts of the food and drink business. And few are doing quite as well as Starbucks, a Seattle-based chain. Last month, the firm's American parent announced that it made 82% more profits during the last quarter of 2014 than a year before, and revealed plans to open another 1,650 outlets around the world in 2015.

But its British subsidiary, at first glance, appears to be doing less well. Last week, it announced its first ever profits in Britain—of just £1m ($1.54m)—in spite of having first set up in the country in 1998 and now having 791 outlets. Analysts say that seems odd in a country that has been crazy about caffeinated beverages since the 17th century and now spends £1.45 billion in coffee shops each year, according to Mintel, a market-research firm.

The main reason why Starbucks has run persistent losses is not due to a lack of interest in its coffee, but to minimise its tax bill. In fact, Starbucks' operating profits are only slightly less in Britain than America. In 2012, it made £70m on £414m of sales of frappuccinos, espresso coffees and the like. However, it also made administrative losses and royalty payments totalling £98m, enabling the division to declare a £30m loss. It is via these payments that the firm has been able to transfer its British profits to its Dutch subsidiary, which is charged lower rates of tax.

Even so, Starbucks is not finding life as easy in Britain as in America. It faces competition from home-grown chains such as Costa, owned by Whitbread, historically a brewing firm, and Caffé Nero, which both charge slightly less for coffee and snacks than their American rival. Accusations of tax avoidance have also damaged Starbucks’ sales to the benefit of its competitors. Polls by YouGov, for instance, found that a third less people rated Starbucks as their preferred coffee shop than they did before the tax-avoidance allegations were first published.

That has forced Starbucks to change its strategy. It has slowed down its expansion plans and has closed down 67 underperforming outlets over the past year. It has also tried to repair its reputation by transferring its European headquarters from Amsterdam to London last April. Although the move has had no impact on its results this financial year, it is expected that it will book its profits from its European business in Britain, rather than the Netherlands, in the future. But that may itself brew trouble. Although British coffee-lovers will be pleased that Starbucks is paying its dues, those from elsewhere in Europe will surely be less pleased.