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FEATURE

HOTEL_ 럭셔리 호텔,
특급호텔의 이정표가 될 수 있을까?

DINING_ 상생과 협력의 해법을 찾아라
젠트리피케이션

HOTEL TREND_ 다시 시작하는 중국 마케팅
CREATIVE HOTEL_ RETRO IN HOTEL

HOTEL SHOW 2018

- I. X세대와 Y세대가 원하는 호텔 디자인은?
 - II. 호텔, 새로운 디지털 트렌드를 찾아
- BEVERAGE ISSUE_ 맛과 향에 취한 호텔쇼

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ARE COFFEE SHOPS A BUBBLE?

“Go into a huge category; ideally a category where there is high incidence and no real cap on marginal utility; price sensitivity is fuzzy; have better/newer branding and better newer assets. Rinse and repeat. Even better when people define themselves by the brand they consume. Welcome to coffee.” -Comment from a long-term friend in the USA franchise finance industry.

According to Inc. Magazine, American venture capital firms are pouring over \$1 Billion into coffee start-ups just in the USA.

Twenty-five years ago, coffee was a boring category with little growth. Starbucks was beginning to be a factor but most Americans were content to buy Maxwell House or Yuban at the supermarket and drink similar quality coffee beverages when dining out. While Starbucks certainly deserves credit for educating the American palate to accept better quality coffee beverages (their food is another matter), there was an unintended outcome – the rise of independent high-quality specialty coffee shops for those snobs that felt Starbucks was just too big & boring a chain to patronize any more.

Coffee consumption is again rising in the USA. In 2016 57% of Americans drank 1 or more cups per day. That number is 64% two years later.

The Indie coffee industry is especially robust with brands like Blue Bottle, Intelligentsia, & Stumptown, etc., all being acquired by large foodservice organizations. Nestle reportedly paid \$450 million for a majority stake in Blue Bottle, a small West Coast based chain with a cult following.

The USA coffee market is estimated at \$12.9 Billion and no player has anywhere near a dominant position, not even Starbucks. There is clearly more opportunity for disruption by new startups. It is noticeable as of late that most trends start from the bottom up not from top down. Cold Brew began as a drink for hipsters and now is a large fast-growing business thanks to Starbucks and many supermarket beverage suppliers. Rise Brewing, a new startup, has a ready to drink cold brew infused with nitrogen to increase energy supposedly. The total refrigerated ready to





drink coffee and tea market is expected to grow to \$116 Billion by 2024 vs, \$71 Billion (2015).

As you can imagine, this gourmet coffee craze is particularly acute with millennials. 48% of them drink a high-end coffee beverage every day! Blue Bottle sells a Port of Mokhu coffee from Yemen for \$16 a cup!

What is the secret formula for the success of Startups?

First is price! It seems the more expensive the coffee the better. There is limited to no price elasticity in this business except perhaps for lower income customers. Second is the flavor profiles of the particular beverages. Every one of these startups has a new gimmick to offer. Consumers have an insatiable curiosity to try new blends. Coffee is becoming like wine or bourbon. Third is the experience. Customers want their coffee blended and prepared just for them. Pour over and siphons are the big deal now. They were also big more than 40 years ago in Japan when I was a frequent visitor to the neighborhood Kissaten (Japanese for coffee shop) as a college student. I usually bought a cup of coffee for 300Yen (about \$1.50 in those days) and then sat there doing my homework for several hours with constant requests for refills of water. It seems that the old coffee culture that traveled from Europe to Japan, Taiwan, Korea & China, has now settled down in the USA for another revival. The old ways become the new!

Is there any peak coming to the artisanal coffee market? Probably not anytime soon, for the key reasons advanced by my finance friend at the beginning of this article. Most people drink coffee and are curious about trying new blends and brewing techniques. There apparently is no marginal utility compared to buying most consumer products. Price is not an issue for millennials apparently. It seems that demand is inelastic for this group. The more expensive the better. Even Tiffany has a Blue Box Café now in their flagship store in NYC. Branding is always improving, especially packaging and store designs. Millennials really care about the product and view the coffee they drink as a statement about themselves – somewhat similar to personal care products. Hermes perfume anyone?

It seems that the love affair with coffee will continue for a while for sure!