Starbucks Coffee Company in the 21st Century

On the morning of March 19, 2008, 6,000 Starbucks shareholders gathered at McCaw Hall in Seattle for the coffee company’s annual meeting. The first in line appeared outside the building’s glass-fronted façade while it was still dark, and before long, the performance hall was packed. As the crowd streamed inside, one team of Starbucks employees handed out cups of hot coffee, while another wrote down shareholders’ comments about the company on stacks of white cards. From the early morning Seattle skyline to the crew of green-aproned workers, the annual ritual was steeped in Starbucks tradition. But for the iconic coffee company, this had been no ordinary year.

Starbucks got its start as a Seattle-based coffee roaster in 1971. At this time, the larger coffee market was dominated by supermarket brands such as Folgers and Maxwell House, and per-capita coffee consumption in the U.S. was on the decline. During the next two decades, however, sellers of specialty, high-quality coffee beans began to attract a niche following. In 1987, entrepreneur Howard Schultz bought Starbucks with an eye toward introducing European-style coffee culture to the American market. Under Schultz’s aegis, Starbucks spread the gospel of high-quality, customized coffee drinks to urban areas around the country. The enthusiasm of Starbucks customers helped the company grow its revenues from about $10 million in 1988 to more than $1.3 billion ten years later. By 2007, the coffee company earned $9.4 billion in revenues through a network of more than 15,000 stores worldwide.

Starbucks performance record since its 1992 IPO made it, for many years, a darling of the investment community. Between 1995 and 2005, the company’s stock rose from about $2 to more than $30, and it remained close to or above that level for much of the following year. But in late 2006, Starbucks stock began a seemingly relentless descent, losing more than half its value in 15 months. (From a value near $39 in November, 2006, it dropped to less than $19 in early 2008.) In February 2007, Schultz, then the company chairman, sent a memo to senior management suggesting that recent decisions at the firm had led to the “watering down of the Starbucks experience” and the “commoditization of [Starbucks] brand” (Exhibit 1). Later that year, Starbucks reported a first-ever decline in same-store sales. In January 2008, Schultz decided to replace CEO Jim Donald and return as the company’s chief executive, a position he had last held in 2000.

The 2008 annual meeting unfolded against a backdrop of stinging criticism in the press. However, the shareholders in Seattle greeted Schultz’s arrival onstage with vigorous applause. “I humbly
recognize and share both your concern and your disappointment in how the company has performed and how this has affected your investment in Starbucks,” Schultz told them. “And I promise you that this will not stand.”\footnote{11} The CEO went on:

There are people in this audience….who believed in a young entrepreneur’s dream that we could create a national brand around coffee, that we also could build the kind of company that had a social conscience that provided equity in [the] form of stock options and healthcare for every single employee, when that had never been done before. And the operative word there is belief, because it’s time to convince you and many other people who are not represented here….to believe in Starbucks again. And that is exactly what we will do today.\footnote{12}

In the course of the meeting, Schultz unveiled six major initiatives designed to help the company reclaim its reputation among consumers, employees, and the denizens of Wall Street. Three of these were directly related to its coffee and espresso drinks. First, Starbucks planned to replace its automatic espresso machines with a new machine called the Mastrena. The Mastrena was smaller than the current equipment, allowing baristas to make eye contact with customers; it also gave baristas more control over the process of preparing a shot. In addition, Starbucks had acquired The Coffee Equipment Company, maker of a machine called the Clover that brewed coffee by the cup. Starbucks also introduced a new roasted blend of coffee beans that Schultz touted as “so fresh that [people who drink coffee with milk and sugar] will want to drink it black.” The Pike Place blend was named after Starbucks first store in Seattle and was served in cups bearing a graphic representation of the company’s original mermaid logo.

Two of the company’s initiatives were directly related to Starbucks relations with its customers. One was a rewards program associated with the Starbucks Card, a prepaid card that customers could use exclusively for Starbucks purchases. Some of the card’s first benefits would include free refills of brewed coffee and free customization options, such as flavored syrups, for all espresso beverages. A second initiative, aimed at increasing communication between customers and the firm, was a new web site called MyStarbucksIdea.com. The interactive site invited clients to share their opinions and suggestions about nearly any aspect of the coffee company’s operations. Starbucks leaders and employees—known as “partners” within the company—would participate in the discussions and officially review the ideas that were voted most popular by the site’s users.

Starbucks final initiative was linked to the company’s longstanding efforts to balance profits with social and environmental responsibility. Since 1998, Starbucks had partnered with Conservation International, a nonprofit group dedicated to preserving global biodiversity by protecting species and their habitats.\footnote{13} Its first efforts with the nonprofit had focused on promoting farms with shade-grown coffee, which provided refuge for threatened animals and songbirds, and on ensuring fair wages and working conditions for farmers.\footnote{14} In 2008, Peter Seligmann, Conservation International’s CEO, appeared at the annual meeting to announce that Starbucks and his organization would also launch an effort to address climate change. “Forests, oceans, [and] rivers are nature’s brilliant operating system,” he said. “The CI and Starbucks partnership is going to focus on protecting the land, water and forests that surround and nurture the most important coffee-growing regions in the world.”\footnote{15}

In closing, Schultz said:

We’ve loved this company and its people and what we do for almost three decades now. And so much of what we’ve been able to do is defined by success and money and things that happen when you’re successful. But it’s never been about the money. It’s been about trying to do something that we believe strongly in, trying to make a difference, trying to build the kind of company that perhaps our parents never had the chance to work for, that had a conscience. And now we’re being tested, for the first time, really...
It’s not about the economy because we don’t want to use that as an excuse, even though it’s a big headwind. It’s not about competition. Don’t believe all the media hype about that. [There are] no coffee wars going on. This is about us, this is about Starbucks.16

The Specialty Coffee Market

When Schultz began building his chain of stores in the late 1980s, the specialty coffee market in the United States was still nascent. But it rocketed to prominence at the end of the twentieth century. Between 1989 and 1999, the number of specialty coffee retailers increased from 585 to 12,000; by the end of 2006, there were nearly 24,000.17 A majority of these cafés were independent neighborhood operations.18 The rest belonged to chains such as Peet’s Coffee & Tea, Caribou Coffee, and Starbucks.

Several forces lay behind the coffee boom. American consumers had become increasingly interested in specialty foods, including organically-grown produce, fine wines, and artisanal chocolate and cheese.19 As well, per capita income was rising, especially for most affluent segments of the population.20 Most households could not come close to affording the extravagances—private jets, second homes, yachts, and more—of the country’s top earners.21 But many could and did buy small luxuries: cigars, a fancy lipstick, a specially prepared coffee drink.22 Passing over the can of coffee in the supermarket for a daily latte or cappuccino, specially prepared in a café, was a way to participate in the nation’s growing wealth.23

The new wave of coffeehouses also conveyed a friendly, relaxed atmosphere that many customers found welcoming. Some, particularly young professionals, adopted coffee stores as a neighborhood hang-out (a trend captured at the time by the television series Friends and its fictional “Central Perk” café). Others, including a growing wave of telecommuters, used coffeehouses as a place to work. As technological improvements made laptops more transportable and wireless Internet became more widespread, café customers perched at the counter or sitting at tables with personal computers became a common sight.

By the early 2000s, established food and beverage chains were eager to populate the mass market for gourmet coffee that Starbucks and other coffee retailers had helped to create. Dunkin’ Donuts, a coffee and donut chain based in New England, began marketing coffee in flavors such as caramel, hazelnut, and toasted almond.24 The chain also offered “Indulgent Iced Lattes” and seasonal drinks such as a Pumpkin Latte and Vanilla Spice Coffee.25 In 2006, Dunkin’ Donuts began incorporating a coffeehouse aesthetic into its new stores as part of a major expansion effort.26 Around the same time, fast-food giant McDonald’s joined the fray with a roll-out of espresso bars inside its restaurants called McCafés.27 The burger chain’s premium drip coffee was well received, beating out both Starbucks and Dunkin’ Donuts blends in a Consumer Reports taste test.28

Espresso drinks at national restaurant chains were the latest sallies in what the media dubbed the “coffee wars.” By the end of 2007, Starbucks had more than 15,000 store locations worldwide. McDonald’s brought the heft of a network twice as large, and Dunkin’ Donuts, with nearly 8,000 stores at home and abroad, was looking to step up its presence outside the northeastern United States.29 McDonald’s and Dunkin’ Donuts’ prices were not always lower than Starbucks for comparable products. However, they marketed their specialty coffees as thriftier, less pretentious alternatives to Starbucks blends. In 2008, for example, McDonald’s launched a web site to promote its McCafés in the Seattle area with web site called “unsnobbycoffee.com.”30 In 2006, Dunkin’ Donuts released a television ad in which confused-looking customers stared at a coffee-shop menu, singing: “My mouth can’t form these words. My mind can’t find these words. Is it French or is it Italian?
Perhaps Fritalian." The company’s corporate web site declared that it was “igniting a revolt against the tyranny of high prices, long waits and confusing sizes.”

As Americans’ taste for specialty coffee grew, other chains more in line with Starbucks coffeehouse image developed devoted followings. Some of these players, such as Peet’s Coffee & Tea, a gourmet coffee chain founded in 1966 by Dutch-born coffee merchant Alfred Peet in Berkeley, California, had helped inspire the very early growth of the specialty coffee market. In the late 1990s, Peet’s began to expand on a significant scale, distributing its product to gourmet and, later, mainstream groceries and opening additional company-owned shops. By 2007, the company had 166 stores in six states, the majority of which were concentrated in its home region of Northern California. The Coffee Bean & Tea Leaf, a coffee and tea chain founded in 1963, was especially popular in Southern California and was often featured in television shows that involved Los Angeles culture. The chain’s network of 520 stores included locations in about 12 countries abroad. In the Midwest, a younger chain, Caribou Coffee, had grown to become a powerful regional competitor. Established in 1992 in the Minneapolis area, Caribou Coffee had nearly 500 stores by 2007. Like Starbucks, these chains emphasized premium coffee beverages and a relaxed in-store experience. They also made a point of contributing to social initiatives in the countries where they purchased coffee.

The expansion of all these chains brought specialty coffee to millions of Americans, fueling more demand, which, in turn, fed the growth of independent coffee shops. As chains proliferated, particularly in certain areas, some consumers left them for smaller, locally-run cafés. This was especially true of those customers who believed that the scale of large coffee chains contributed to the commoditization of the coffee-drinking experience and a diminution of the barista’s art. In Chicago, for instance, a barista at the Intelligentsia Coffee and Tea shop, a local chain of four stores, told the Chicago Tribune that he considered himself “a cross between a sommelier and a bartender.” An employee at another area coffee shop suggested that Starbucks workers, by comparison, were lacking in skills and knowledge. Starbucks partners were “button pushers,” he said, “no different from fry chefs at McDonald’s.”

In an interview with the Calgary Herald, Manthri Srinath, owner of three independent coffee shops in Santa Cruz, California, spoke to the dynamic he saw between Starbucks and its neighborhood competitors. “Starbucks created legions of folks interested in coffee as an epicurean experience, and then abandoned them for the greener pastures of Pomegranate Banana Frappuccinos,” he said. “The rest of us are now playing in their old playground.”

The Growth Imperative

By 2007, Starbucks Coffee Company had become the largest specialty coffee retailer in the world, with more than 15,000 stores globally and revenues in excess of $9 billion. To reach this store count, the company had opened units at a remarkably rapid rate. For example, in 2000, Starbucks operated 3,501 stores; on this base it had expanded more than fourfold in six years, and company leaders had declared that the business was poised for even greater expansion the years ahead. (For a detailed chronology of Starbucks from 2000-2007, see Exhibit 2).

The United States was Starbucks largest market, with 10,684 of the company’s outlets, up from 3,150 in 2000 (see Exhibit 3). In many large U.S. cities, there were multiple Starbucks locations within just a few blocks of each other. In Manhattan, for instance, some buildings, including the Marriott Marquis hotel and Macy’s flagship department store, actually had two Starbucks stores within them. Seattle, Starbucks home city, had a particularly high concentration of stores with one for

Purchased by Anja Purcell (granj06@yahoo.com) on November 16, 2011
every 13,000 people (the nationwide average was less than half as dense, with one store for every 28,000 people). At one intersection in Seattle there were Starbucks stores on three corners, and the company was considering placing a store on the fourth as well. Still, nationwide, the company had not seemed to reach a saturation point relative to market demand. “It defies standard retailing knowledge,” said Jim Alling, president of Starbucks Coffee International.

The company’s global presence had also increased significantly. In 1996, Starbucks had opened its first store outside of North America—in Tokyo, Japan. Eleven years later, the coffee retailer operated 4,327 stores outside North America (see Exhibit 4). (In Tokyo alone, there were 109 stores.) Expansion spanned many continents, with stores opening in Asia, Europe, the Middle East, Africa, and the Americas. The company’s global reach was a dramatic change from the late 1980s when Schultz had purchased the enterprise—there were 11 Starbucks stores in 1987—and even from the mid-1990s, when Starbucks had 680 stores, all of them in the United States and Canada.

In 2006, the company had announced a long-term goal of operating 40,000 stores around the world. Achieving this target would be difficult enough in itself. But for Starbucks, the imperatives of expansion were complicated by senior management’s commitment to stay true to the organization’s original mission. From the start, Howard Schultz had dedicated himself and his initial team to building a company that provided generous benefits to its employees, delivered outstanding service based on personal relationships with customers, and acted as a responsible corporate citizen. Yet the close, human relationships with employees and customers on which the mission was based were becoming harder and harder to maintain as the number of stores grew. In addition, socially conscious consumers and activists were increasingly skeptical of yet another multi-national company with an aggressive growth agenda, particularly one that also claimed to be socially responsible.

In 2003, Schultz had spoken optimistically about the company’s ability to reconcile its growing scale with its original core values:

Somewhere along the way, when we assessed the size of the market, the size of the prize, we concluded that the destiny of the company was to create a worldwide enterprise. But the question was not how big we could become, but could we get big and stay small? Could we maintain the intimacy with our customers? Could we maintain and preserve the culture and values of the company? Most important, could we continue to build the company that achieved the fragile balance between the fiscal responsibility of making a profit, and, most important to me personally, the benevolence of having a social conscience? We then concluded that we could do both…

But during the ensuing four years, achieving its two overarching goals—pursuing an aggressive growth agenda and maintaining a larger social mission—began to appear less certain. By 2007, Schultz himself was expressing concern over these same issues in a memo to the company’s senior leaders (see Exhibit 1):

Over the past ten years, in order to achieve the growth, development, and scale necessary to go from less than 1,000 stores to 13,000 stores and beyond, we have had to make a series of decisions that, in retrospect, have led to the watering down of the Starbucks experience, and, what some might call the commoditization of our brand... We desperately need to look into the mirror and realize it's time to get back to the core and make the changes necessary to evoke the heritage, the tradition, and the passion that we all have for the true Starbucks experience... We have built the most trusted brand in coffee in the world, and we have an enormous responsibility to both the people who have come before us and the 150,000 partners and their families who are relying on our stewardship.
Seen from a larger perspective, the coffee company’s reputation depended on its ability to make its unique way of doing business as well-known in the larger culture and economy as its ubiquitous mermaid logo. This meant that Starbucks had to maintain the trust and energy of its workforce as it learned how to communicate and operate on a bigger scale. Finally, the company had to sustain and, in some instances, enlarge its longstanding commitments to other stakeholders and the environment. Doing all these things while continuing to grow quickly would require careful deliberation, great deftness, and sustained dedication at virtually all levels of the organization.

Rationale for Growth

Starbucks expansion strategy was fueled by the company’s ambition to spread its product and values wherever there was demand. For most of the company’s history, in fact, communities had clamored for Starbucks presence. Opening new stores tended to have positive effects on the neighborhoods in which the stores operated and for participants in Starbucks’ supply chain. But the growth imperative had other important sources as well. One was competition. As the specialty coffee market attracted chains that sought to emulate the frontrunner’s success, the company wanted to make sure that consumers had the chance to visit a real Starbucks store. Another, powerful factor driving the firm’s trajectory was Wall Street. As a public company, Starbucks was under constant pressure to improve its financial performance from quarter to quarter. Expanding the store network and product line allowed Starbucks to consistently boost its revenues, ensure continuing returns for its investors, and increase its market valuation.

The number of Starbucks stores had a powerful impact on employees, coffee farmers, and coffee-growing practices. For the firm’s partners, who were offered generous benefits, and coffee producers, who were paid above-market prices, the chain’s expansion was arguably positive. Enlarging the business created more jobs and more demand for coffee and other inputs purchased from suppliers. In this way, tens of thousands of people around the world were directly affected when Starbucks decided to open additional stores. In areas where Starbucks provided better benefits or offered higher prices for inputs than other, similar firms, the people who engaged with the company as employees or suppliers enjoyed a higher quality of living. “Starbucks buys only about two percent of the world’s coffee beans, but as an industry leader and specialty coffee retailer with thousands of locations worldwide, we have an opportunity to lead change,” said Dub Hay, Starbucks senior vice president of coffee. “We are very excited about the positive impact Starbucks can have on coffee farmers, their communities and the environment.”

Starbucks growth also had significant second-order effects, such as disseminating high standards for coffee growers. The company’s demand for coffee that was shade-grown or planted and harvested by farmers making a fair wage, for instance, helped spread such practices and raised awareness about them. Peter Seligmann of Conservation International emphasized Starbucks influence in the environmental sphere. “Global companies are often criticized for the scale of their operations,” he said. “This scale is exactly why CI believes that Starbucks is an excellent partner, because scale is important when dealing with a huge issue like climate change. Starbucks ability to reach millions of people in the market every day and connect them to the land and to the people that grow and process coffee is critical to meet [this] challenge.” As Starbucks footprint grew, the positive effects of its expansion on stakeholders became clear. This impact contributed to the idea that the company had a global “destiny” and helped drive its future ambitions.

Competing retailers in the specialty coffee market provided another incentive for the company to reach out to a larger base. The entrance (and frequent success) of these players suggested that Starbucks had much more room to grow in the developing specialty coffee market. In fact, other companies would almost certainly try to capture consumer demand if Starbucks did not. With some
coffee chains poised for their own growth spurts, and others, like McDonald’s, ready to introduce espresso products into an existing network of stores around the world, Starbucks needed to move quickly if it was going to keep its place as the market leader. But, ironically, Starbucks downplayed the impact of competition on its expansion plans. “[Consumers] are going to trade up” when they try other chains’ coffee, Schultz stated, “because they’re not going to be satisfied with the commoditized experience or the flavor.” Still, the forays of other firms—from Caribou Coffee to Dunkin’ Donuts to McDonald’s—into designer coffee could not be ignored.

Outside the company, Starbucks stakeholders supported the expansion strategy because of its implications for the firm’s stock. The investment community had long nurtured outsized expectations for Starbucks, in large part due to the company’s remarkable track record. As the business grew, it had consistently met and often exceeded its performance targets. For example, since 1988, net revenue had increased by an average of 45%, and by the end of 2007 the company had achieved comparable store sales growth of 5% or higher for 16 consecutive years. Starbucks operating margin had improved from 9.7% in 2000 to a high of 12.3% in 2005. (In the following two years, however, operating margin fell some to 11.2% in 2007.)

The company’s strong financial results were reflected in its stock price. In 1992, Starbucks went public, and its valuation had climbed steadily through the decade. The stock price stagnated a bit from 2000 through 2002, in line with the S&P 500, and then experienced two years of steady appreciation in 2003 and 2004. Performance in 2005 and 2006 had been uneven. The stock price dropped for most of 2005 and then increased through the first half of 2006. After another brief dip and rise, it fell almost continuously throughout 2007 and into 2008. Yet even with the mixed performance in recent years, the stock price had appreciated over 2,500% since the company’s IPO (Exhibit 5).

Financing from the stock market helped Starbucks build an international brand and become an icon in a relatively short time span. It also helped the company create the infrastructure necessary to maintain tight control over the processing and distribution of the coffee beans and over the store network. In 1993, a year after going public, Starbucks added a coffee-roasting facility in Kent, Washington, to supplement its original Seattle roasting plant. By 1998, it had added a roasting and distribution facility on the east coast, in Pennsylvania, and another one abroad, in London, England. The store network grew primarily through company-owned stores (Starbucks did not franchise), which formed the majority of the network, and to a lesser extent through licensed stores, which were located mainly in airports.

Overall, the public offering yielded enormous benefits for Starbucks, allowing it to raise the funds necessary to build the chain domestically at a crucial juncture in its corporate history. In 1992, it had issued 1.5 million shares of stock at $17 a share, raising $29 million. By the standards of the company in the twenty-first century, this was a small sum, but at the time, it was more than six times the company’s annual profits. That year, the company’s market capitalization was about $200 million; by the next year, it had climbed to $684 million. Four years later, in 1997, the company was valued at $2.9 billion; in 2008, it was worth more than $12 billion.

Starbucks historic sales growth and the corresponding appreciation in its stock price had led the investment community to expect—and indeed, evaluate the company on—continued expansion. The most important metric that analysts used to assess the chain (and many other retail businesses) was the rate of comparative-store sales, which measured how fast sales were growing at stores open at least a year. Strong comp-store sales suggested that the firm was expanding organically, that its stores continued to attract new business over and above that generated by opening new outlets. Slowing comp-stores sales, however, could indicate that the chain’s newly opened stores were
cannibalizing existing ones, that competition was pulling sales away, or that the broader market was becoming saturated.

Wall Street analysts responded swiftly and dramatically when Starbucks monthly and quarterly “comps,” as they were known, did not keep pace with the company’s white-hot growth record. In the summer of 2006, for example, Starbucks announced that July comparable-store sales had increased by 4%, at the low end of the 3-7% range previously projected by the company. Michael Casey, Starbucks executive vice president and chief financial officer at the time, explained that the company’s performance had suffered as a result of slower preparation times for frozen and iced drinks, which were in high demand due to a heat wave across the United States that summer. Starbucks stores had not been prepared—particularly in the morning—for the rush of orders for these labor-intensive beverages. Casey’s reasoning did not pacify the Street. The day after the announcement, the stock fell nearly 8%. (Later that year, due in part to the volatility provoked by such frequent announcements, Starbucks announced that it would no longer provide sales results on a monthly basis.)

By the 2000s, Starbucks expansion was funded primarily by the company’s own cash flow rather than external financing from the capital markets. But the stock price still mattered a great deal, in and outside the company. Company stock was a component of management’s compensation and, through the Bean Stock program, of a large swath of its workforce. The price of the stock and the ratings of Wall Street analysts also had an enormous influence on how the company was valued and viewed in the market at large. This was especially true for the media’s perception of a given company. Reporters were quick to latch onto a falling stock price, often pointing to this as evidence of a larger, more dramatic decline in the business. For Starbucks, as for many public companies, this relationship with the financial markets could be a double-edged sword. The market imposed a kind of discipline on firms, generally regarded as beneficial, that could motivate managers and organizations and help them avoid complacency and stagnation. But it also made companies beholden to the Street, particularly analysts, and thus to short-term performance indicators. Starbucks leaders were under intense pressure to report the numbers that financial analysts expected and to justify any diversions from a historic path of growth and success.

**Sources of Growth**

Between 2000 and 2007, the upward swing in Starbucks revenues and earnings had come primarily from new store openings and increased business at existing stores. In the United States, for example, the number of stores opened per year grew from 750 in 2002 to 1,200 three years later. During the same period, average annual store sales increased from approximately $800,000 to $900,000. Much of the growth in sales at existing stores had come from new products, including new beverage and food offerings, books, music, movies, and other goods.

Going forward, Starbucks could continue to open retail stores in the United States, where it was able to achieve operating margins of over 15%. At the same time, it could ramp up its branded offerings outside of coffee products. But these types of efforts—as appealing as they were for promulgating the mission and satisfying the Street—carried risks for the company and its brand. There was no guarantee that customers and employees would still be able to experience a personal relationship with Starbucks once it reached its long-term goal of 40,000 stores worldwide. In addition, the pursuit of branding opportunities in products not clearly related to coffee had the potential to dilute the company’s focus. As Schultz noted, selling more products and operating more stores required certain standardizations. These procedures could cause Starbucks to be perceived as a “sterile, cookie cutter” retail chain.
International Expansion  Although the United States remained Starbucks largest and most profitable market, a significant part of the company’s future revenues was expected to come from outside North America. Starbucks had become a cultural icon due largely to its organic growth in the United States. The worldwide push, however, was unlike anything the coffee retailer had previously attempted in terms of both speed and scale. In the early 2000s, Starbucks had steadily increased its roster of international stores, from about 1,200 in 2001 to approximately 4,300 six years later. Between 2009 and 2011, Starbucks planned to open a total of 3,500 stores abroad at a rate of more than 1,000 each year. This target was more than double the number of stores the company had opened internationally in the first six years of the century.

Starbucks primary strategy for entering new global markets was to create a joint venture with a local firm, often one in the retailing or restaurant business. Starbucks would then form a licensing agreement with its joint venture partner and over time, increase the Starbucks ownership stake to at least 50%. The focus on working with partners was driven by the company’s plan for rapid growth and the need for on-the-ground knowledge and expertise. In choosing players to work with, executives looked for companies that shared Starbucks standards and values. Financial resources were less important. There were plenty of organizations with deep pockets lining up at Starbucks door, but without a fit on principles, the partnerships were higher risk.

A second aspect of Starbucks international strategy involved focusing efforts on a small number of countries with significant growth potential. Although executives had announced plans to operate in 54 countries by 2011, they intended to concentrate on four large markets: Brazil, Russia, India, and China. Late in 2006, Starbucks opened its first two Brazil stores, in São Paolo, the country’s largest and wealthiest city. The store aesthetic was similar to that found in other Starbucks locations, but the menu included local specialties such as Brazilian cheese bread. By 2007, Starbucks had over 500 stores in China and expected to ultimately have 2,000 stores there. The coffee retailer had also opened its first store in Russia and was making plans to enter India. In India, Starbucks would focus initially on Delhi and Mumbai, cities with large populations of young people with spending power.

Starbucks international strategy also involved careful attention to differences in cultural tastes and preferences. For example, although most transactions in the firm’s United States stores were takeaway, in China and other Asian countries 80-90% of purchases were consumed in-store. In China’s crowded cities, these stores served as meeting places for the growing number of middle-class consumers. Evening social gatherings at Starbucks proved so popular in China that the outlets there adopted larger café areas and more seating than their American counterparts. Some Chinese customers admitted they did not actually like the taste of coffee in general, finding it bitter in comparison to tea, but they patronized Starbucks anyway because of the image of “relaxed affluence” it conveyed.

In Asia, Starbucks entered countries with little in the way of coffee-drinking traditions; in Europe, the company had to contend with the opposite set of issues. In Austria and France, for instance, coffee and cafés had been part of the respective cultures for centuries. When Starbucks opened its first store in Austria in 2001, there was already one coffeehouse for every 530 people. To accommodate local tastes, the Starbucks menu in Austria offered smaller cookies and muffins with less sugar. But in Austria, as in most international markets, Starbucks retained its core drink offerings as well as its no-smoking policy, despite the fact that an estimated 40% of Europeans smoked. These decisions illustrated the trade-offs between customization and consistency that senior management would have to continue to consider as it expanded globally.

New Products and Services  In addition to international expansion, Starbucks relied on new products and services as a major driver of future growth. Company executives devoted increasing
attention to items outside of the standard espresso menu that they believed would enhance the customer experience. “It’s more than just coffee, it’s human connection,” Schultz explained. “We want to add texture to the brand, and value to the experience.”

This was accomplished through an enlarged food and beverage menu in company stores, a line of ready-to-drink beverages and other consumer products sold in grocery and warehouse club stores, and a series of entertainment initiatives. In fiscal 2005 and 2006 alone, Starbucks began selling 22 new beverages, and by the end of the following year, customers could order from a menu with over 87,000 possible drink combinations. Starbucks blended beverages were among the most popular of the new offerings. In 1995, the company had introduced its first blended beverage, the Frappuccino®. Made from a mix of coffee, milk, sugar, flavorings, and ice, the original Frappuccino had a milkshake-like consistency. A “light” version was introduced in 2004, with 30-40% fewer calories than the original, and in 2006, the company introduced non-coffee-based blended beverages in fruit, tea, and crème flavors. The company also expanded its line of traditional espresso-based drinks with offerings such as White Chocolate Mochas and Cinnamon Dolce Lattes, as well as seasonal flavors such as Pumpkin Spice and Peppermint. Customers could tailor their drinks by specifying the type of milk (non-fat and soy milk were available), topping, and syrup they preferred.

Starbucks also broadened its food menu, adding a variety of breakfast, lunch, and dessert options. However, the company was careful to tailor its offerings to the coffeehouse environment. In early 2008, for example, Starbucks abandoned a lucrative line of warm breakfast sandwiches because their smell interfered with the coffee aroma in stores. In 2006, the company introduced non-original drinks on the model of the Frappuccino. In the summer of 2008, Starbucks would offer a healthy beverage in two flavors made with protein and blended fruits. In select markets, it also planned to begin selling a proprietary drink that company leaders had found on a visit to Italy.

Another avenue that helped expand consumer awareness was a line of Starbucks-branded products sold in grocery stores, warehouse clubs, and other retail outlets. These products were marketed and distributed through licensing arrangements. In the late 1990s, for instance, Starbucks entered into an agreement with Pepsi-Cola to sell bottled Frappuccino drinks in supermarkets. By 2006, the lineup of licensed products included whole bean coffee, Tazo® tea, bottled DoubleShot® espresso drinks, coffee liqueurs, and superpremium ice creams. Revenue from these products was only about 5% of total net revenues, but the impact in terms of increased visibility of the brand was likely much greater.

Starbucks food, beverage, and consumer product initiatives were close complements to its original focus on coffee. But the company was also branching into the world of media with offerings in music, books, and movies. The idea of selling music arose in the late 1980s, after one Starbucks manager who had made compilation tapes to play in his store received so many requests from customers who wanted to buy the recordings that Starbucks decided to license and sell them. Schultz had initially been skeptical of the company offering music. “I had to get talked into this one,” he explained. “But then I began to understand that our customers looked to Starbucks as a kind of editor. It was like, ‘We trust you. Help us choose.’” In 1994, Starbucks started selling CDs in stores, and in 1999, it purchased Hear Music, a company that developed compilation CDs of classic and contemporary tunes. By 2005, Starbucks was selling over 3.5 million CDs a year. One of the Hear Music unit’s most successful projects was a Ray Charles album, “Genius Loves Company,” which won eight Grammy Awards and sold over 800,000 copies—about 35% of total sales—in Starbucks stores.

In 2004, Starbucks formed an Entertainment division in order to move beyond music. The first initiatives in this area were focused on promoting books and DVDs in U.S. stores. Two years later, in 2006, the company made its bookselling debut with For One More Day, a novel by the bestselling...
author Mitch Albom. The same year, Starbucks partnered with Lions Gate Entertainment to market the feature film, Akeelah and the Bee, a story about a young African-American girl who enters a spelling contest. In 2007, Starbucks entered a new venture in China that gave it a role in content creation as well as marketing. The coffee retailer helped finance a romantic drama in which much of the action took place in a Starbucks store. The film, called “A Sunny Day,” aired in daily segments throughout the Shanghai subway system.

The broader objective underlying the ventures into music, books, and movies was to enhance the experience Starbucks provided and thus to enrich the brand. Product expansion also provided a source of incremental revenue that would help the company continue to meet investors’ growth expectations. Although most new products and services still comprised a relatively small percentage of Starbucks total revenues—in fiscal 2005, for example, the entertainment initiatives represented less than one percent of the top line—the rationale was that these offerings helped drive comp-store sales growth, a metric on which analysts were keenly focused.

Some Wall Street analysts applauded Starbucks efforts to enlarge its product offerings. “If the business remained a coffee destination and nothing else,” commented CIBC analyst John Glass, “same-store sales would not increase. It’s a public company. Their job is to make money for the shareholders by selling more stuff.” But others were more critical of the new ventures. They argued that the company was losing sight of its original identity as a coffeehouse and becoming a bland, homogenous purveyor of cultural goods. Some of these concerns, from critics outside the financial markets, echoed those that Schultz had voiced in his 2007 memo to the senior team (see Exhibit 1). For example, brand consultant Harvey Hartman commented that Starbucks had been “built on the coffee experience, and by moving so far beyond that, they are jeopardizing everything else.” Writing in the New Republic, music critic David Hajdu suggested that Starbucks jazz and popular music compilations “reduce[d] musicians with complex bodies of work to simple images to which young consumers of venti frappuccinos can relate.”

In 2008, the entertainment division, like other aspects of the business, came under internal scrutiny. “As part of our ongoing transformation, we are committed to examining all aspects of our business that are not directly related to the core,” Schultz said. The coffee company planned to continue offering music, particularly in the digital sphere, through a partnership with Apple’s iTunes. It would also continue to evaluate new book projects. However, Starbucks turned the management of Hear Music over to its partner in the venture, the Concord Music Group. Schultz also reported that the firm did not anticipate marketing any more movies.

Headwinds and Challenges

In January 2008, soon after taking up the reins again as CEO, Schultz announced a shift in the company’s growth strategy. The coffee business would reduce its overall annual targets for store openings, scaling back plans for the United States in particular. It would also close 100 of the least profitable stateside outlets. In April, Schultz lowered these yearly targets even further. The company did not officially retrace its long-term goal of 40,000 stores, but the timeframe of this growth was significantly extended. By 2011, the company announced, it expected to have 21,500 total stores. Most of this growth would come from the pursuit of international opportunities. Within the next three years, senior management expected the proportion of international stores in its network to increase from 30% to more than 40%.

As it pressed ahead with its expansion plan, Starbucks faced a range of challenges. One of the most significant was the state of the economy in the United States, where it still operated a majority of its stores. In 2008, the economic situation was characterized by an overarching uncertainty, even
pessimism, which differed markedly from the preceding four years. The financial markets were reeling from a crisis related to subprime mortgages, many of which had been packaged into securities and sold to institutional investors. A range of international and domestic investors had purchased these securities, often with very damaging—in a few instances, near-disastrous—results. In March, analysts at the investment bank UBS estimated that total losses from securities “backed by mortgages and other debts” would amount to $600 billion.\(^{105}\)

At the level of the American consumer, a sagging real-estate market made it much more difficult to sell a home or tap into home equity, thus significantly reducing household liquidity and in many cases, financial stability. By late April 2008, housing prices in the United States had fallen nearly 15% from a high almost two years earlier.\(^{106}\) For some homeowners, particularly those who had taken out subprime mortgages or mortgages with a variable interest rate, house payments had become unsustainable, and a record number of families had lost their homes in the wave of foreclosures sweeping the country. (In the last quarter of 2007 alone, more than 1 million borrowers were in foreclosure, and another 3 million were behind on mortgage payments).\(^{107}\) Many who held onto their homes had seen property values fall precipitously and were thus unlikely to spend as freely as they had in the past.

Even families relatively unaffected by the housing woes were under increasing pressure to rein in discretionary spending as prices for daily necessities such as food and gasoline rose swiftly. Between June 2007 and June 2008, the price of gas increased from about $3.16 to nearly $4.00; over approximately the same period, the prices of eggs, milk, and cereals and bakery products rose 30.5%, 13.5%, and 8.9% respectively.\(^{108}\) For most consumers, gains in income were small or negligible, and did not come close to offsetting the higher cost of living. In the first years of the twenty-first century, median household income, adjusted for inflation, actually declined.\(^{109}\) This meant that many families could no longer afford some of the things they had become accustomed to in the years when the economy had expanded with relatively little inflation. At the same time, the unequal income distribution that had accompanied the coming of the Information Revolution in the late 1990s and early 2000s continued to unfold, with the top 1% of Americans receiving a larger share of the nation’s income than it had since the 1920s.\(^{110}\) Overall, Americans felt—and many were in some sense—poorer than they had in years. More than half reported either high or severe anxiety over their “personal economic and financial situations.”\(^{111}\)

For some industries, this strange, uneasy economic environment was a boon. Oil companies, such as Exxon Mobil and Shell, reported enormous profits driven by global demand for oil, diesel fuel, and gasoline.\(^{112}\) Agribusiness firms such as ADM and Monsanto profited similarly from a rising demand for grain.\(^{113}\) For most of the retail sector, however, the same economic factors spelled trouble. Because consumers reacted to higher prices for basic necessities by closing their pocketbooks to all but essential expenditures, sales at many jewelry and clothing chains dropped markedly. Some, like Foot Locker and Ann Taylor, announced plans to close hundreds of stores; others filed for bankruptcy.\(^{114}\) Low-priced retailers, such as Wal-Mart and Costco, fared better.\(^{115}\) So, too, did the outlets of some luxury chains.\(^{116}\)

The press was quick to pounce on the potential consequences of the economic downturn for companies like Starbucks. The \textit{Wall Street Journal} noted that the firm’s “customer base ha[d] gradually broadened to include Americans with lower average incomes, a group more likely to cut back.” Some newspapers and newsmagazines were harsher, forecasting a dim future for the once-dazzling chain. “America has fallen out of love with Starbucks almost as quickly as it fell in love with it,” reported England’s \textit{The Sunday Telegraph}. “A declining brand, soaring commodity costs and America’s general economic malaise have taken the buzz out of the world’s best known coffee shop chain.”\(^{117}\)
The $4 latte was not the only aspect of Starbucks business to fall under the harsh glare of a critical media. Several journalists used Schultz’s return and the larger economic moment as an opportunity to scrutinize the company’s growth strategy. In early 2008, Joe Nocera, a business columnist for the *New York Times*, wrote: “How do you train enough people to staff 40,000 stores? How do you maintain quality? How do you keep your stores from becoming just another nondescript chain? You don’t….If you are going to fix what ails Starbucks you have to forget about growth. And you have to stop thinking of your company as a sexy growth company. Those days are over.”

Starbucks had staked its brand on the global appeal of premium coffee served by baristas who connected with customers on a personal level. The company’s expansion depended on its ability to demonstrate this and other differences from its mass-market competitors. But as reporters and analysts were quick to note in early 2008, Starbucks no longer had a monopoly on the concept of customized coffee beverages. In addition to installing espresso machines and upgrading their drip coffee, many other food and beverage chains had copied Starbucks offerings, such as its signature Frappuccino drinks. Dunkin’ Donuts, for instance, offered several flavors of iced lattes, including Caramel Swirl, and a hot mocha drink called a Dunkaccino™. These chains were actively pursuing consumers who had developed a taste for high-quality, individually prepared coffee drinks but had not necessarily become loyal Starbucks customers.

Starbucks confronted these challenges from a relatively strong position. According to one survey, 28% of regular coffee drinkers chose to get their fix there, more than at any other chain. The coffee retailer’s most loyal customers visited a Starbucks store an average of 18 times per month. But the distinctive blend of quality coffee and neighborly camaraderie that Starbucks offered was not a complete insulation against the pressures of a challenging economy. Even loyal customers might begin to indulge in the company’s drinks less often if they felt pressured by their financial situation. Other fans might begin to brew coffee at home, whether Starbucks or another brand, such as Dunkin’ Donuts or Green Mountain. With many consumers more cautious about their daily expenses, coffee retailers of all stripes had to find new ways to communicate the value of their products and their store experience. The initiatives that Schultz had unveiled at the annual meeting were designed to address precisely this set of issues.

### The Changing Organization

Along with external difficulties such as the economy and increasing competition, Starbucks leadership had to contend with evolving challenges within its own organization. The expansion of the Starbucks store network and product line had affected partners, the company culture, operations, and marketing in various ways. Since 1987, when Schultz had acquired Starbucks and started building a national network of stores, the coffee retailer had based its approach to people and culture on personal connections with employees. These connections were the animating core of the organization and played an important role in both its internal strategic decisions and its public image. But the direct relationships that historically the company put such a premium on were becoming more difficult to sustain as the Starbucks workforce grew. By 2015, the company planned to employ close to half a million people. In this context, how could the senior team maintain the small-company feeling and personal ties that had been central to Starbucks success?

Similar tensions dogged operations and marketing. As the organization increased in size, Starbucks had made a number of changes intended to boost efficiency and thereby satisfy investors’ expectations for continual advances in performance. But efficiency gains often involved standardizing work processes and supplementing or even replacing human tasks with machines. By depersonalizing the jobs of frontline workers, these changes threatened to alienate employees and
customers. In marketing, Starbucks faced the difficult task of adapting a strategy based on word-of-mouth and personal connections between customers and baristas to the needs of a much larger company. Although the company had been trying to scale its marketing efforts for many years, the task had become increasingly demanding as the pace of growth increased.

**Human Resources**

Starbucks attitude toward people had its roots in Schultz’s original vision for the company. As a child, he had witnessed his father lose his job after a workplace injury and experienced first-hand the family’s struggles to get by without health insurance or workers’ compensation. This had had a powerful effect on the future entrepreneur, and early on, he vowed that if he had the opportunity to build an organization, it would be one that took care of its people. From the time he acquired the company, Schultz believed that it had an obligation to treat its employees with respect.

Schultz’s vision had come to mean not only fair wages—the starting hourly wage for a barista in New York City in 2006, for instance, was $8.75, $2.00 more than the state’s minimum—but also generous benefits and a financial stake in the growing organization. In 1988, for example, Starbucks began offering health-care coverage to all employees who worked at least 20 hours a week, and 20 years later this remained a very attractive feature of working for the company. In 1991, the company introduced an employee stock option plan called Bean Stock, and this, too appealed to applicants and employees. Starbucks also invested heavily in training programs for baristas and managers. A 25-hour training program for all new hires was introduced in the late 1980s, and by the mid-1990s, it had been expanded to a full three days of educational sessions covering topics such as coffee brewing techniques, the history and connoisseurship of coffee, and customer service.

Partner benefits such as health insurance and stock options represented a significant cost to the company. But Schultz and other senior leaders believed the (often intangible) advantages of such policies outweighed their financial cost. For instance, comprehensive benefits attracted talented and committed job applicants. As important, the company believed that its hires were more likely to offer friendly, enthusiastic service to customers when they themselves were treated with respect and compensated well for their efforts. Partners were also more likely to stay with the company, which in turn helped to create a more productive workforce, one that could deliver better service to customers. Long-time baristas, for example, came to know customers by name and anticipate their drink orders when they walked in the door.

During the 1990s, Starbucks human resources policies served the company well as it grew to 45,000 employees. In late 2007, however, Starbucks employed 172,000 people (see Exhibit 7) with plans to increase this number nearly threefold by 2015. Offering benefits to all partners in this environment would not be easy. By 2005, for instance, Starbucks expenditures on health insurance exceeded those on coffee beans. In the years when the company’s stock was a top performer, these human resource outlays went largely unchallenged by the investment community. But as the stock price began to slump, the Street was likely to scrutinize many of the company’s expenditures, like health benefits, much more closely.

The monetary cost of benefits was not the only aspect of partner connection that risked strain with the organization’s size. Maintaining relationships with partners was also increasingly difficult, as demonstrated by employee tenure. In 2004, Starbucks employee turnover was approximately 80%. Although this was much lower than turnover in the restaurant industry as a whole—which was often more than 200%—it was much higher than the company’s rate of about 60% in the mid 1990s. Higher turnover meant that more resources had to be devoted to training. More important, greater
turnover jeopardized the sense of community, cultural continuity, and “small-business” values that the company had worked hard to create among a diverse and far-flung workforce.

Starbucks leaders sought to enrich and, in some cases, restore connections within the firm by seeking out and responding to feedback from its partners. In particular, they examined factors such as whether partners were happy with their jobs and whether they felt meaningfully involved in their work. In its 2006 Partner View Survey, for example, the company found that 86% of partners felt satisfied in their jobs, up from 82% in 2003. During the same period, the proportion of Starbucks partners who felt engaged in their work fell slightly, from 73% to 69%. Two of the main matters that partners flagged for improvement were pay and benefits and job opportunities. Starbucks addressed these issues by increasing wages for most hourly store partners in the United States. In addition, it began to develop tools that would aid internal hiring and help partners learn about and prepare for future career opportunities within the organization. In 2008, Schultz announced that he would also reinstate the company-wide employee leadership conference that had been cut a year earlier to help pay for raises.

Another area in which Starbucks leaders encouraged input from partners was the implementation of the firm’s mission. This was accomplished through a feedback mechanism called Mission Review, which enabled workers to critique and challenge policies they perceived as inconsistent with the Starbucks mission and values. The company’s leadership promised a swift response to partner comments. Executives shared employee concerns with leaders throughout the organization. Through Mission Review, for example, individual partners might question a lack of investment in a run-down facility or a decision to reduce labor hours at a store where sales remained high. “It’s self-criticism that’s balanced,” said David Johnson, Starbucks Mission Review Director in 2005. “These are people who are passionate about our products and our company. They say, ‘I am entitled to ask these questions.’"

As the scale of the organization grew, maintaining the quality and dedication of Starbucks executive team was also a challenge. Just as Starbucks partners were expected to be knowledgeable about the espresso craft, it was important for company executives to understand and value Starbucks coffee products and its larger mission. This made hiring and promoting people from inside the firm ideal. But the coffee company’s rapid growth made it hard to develop the requisite number of people quickly enough to fill every leadership position. Additionally, several longtime Starbucks executives had retired or left the firm in recent years. In 2007 Michael Casey stepped down as Starbucks chief financial officer after more than 12 years in executive positions (he remained involved with the firm as a senior advisor). The same year, Anne Saunders, Starbucks senior vice president of Global Brand Strategy and Communications, left after more than five years. In 2008, Launi Skinner, who had been a member of the Starbucks team since 1993, resigned as Starbucks U.S. president.

Organizational Culture

One of the aspects that had originally attracted consumers to the firm was its unique coffeehouse culture, which Starbucks senior leadership helped shape through decisions about the company’s values and ways of doing business. But it was the workers on the front line who communicated the company culture directly to customers in markets around the world. Management supported these employees by providing some general guidelines for customer interactions. It also educated partners about the mission and, through Mission Review, encouraged them to speak up about the ways that this was implemented in the stores. Most important, it made sure to give its partners expert training in the art of coffee- and espresso-making.
Starbucks image in the public sphere was largely dependent on the millions of daily exchanges between partners and customers. Executives believed that these interactions should be natural, not scripted. But the company also provided partners with a basic set of expectations. For example, the 2006 version of the company’s employee handbook, called the Green Apron Book, detailed five “ways of being” that baristas were expected to follow with customers: “be welcoming, be genuine, be knowledgeable, be considerate, and be involved.” Within each category, there were prescriptive statements about how partners should behave, such as “provide uplifting experiences that enrich your customers’ daily lives” and “get to know your customers by drink or name.” The intent was to offer broad guidelines, not rigid behavioral rules, that partners would put into practice differently depending on their own instincts and the communities in which they operated.

Underlying the company’s connection to customers was a basic commitment to coffeehouse culture. Training Starbucks partners in the history of coffee and the art of the espresso beverage helped reinforce the link between the organization and its core product. In the years right after Schultz started building the business, the sight of bins of roasted coffee beans and baristas who expertly manned the manual La Marzocco espresso machines had communicated the message that Starbucks was serious about coffee. But as the retailer transitioned to automated machines and incorporated thousands of new hires into the organization, the significance of the barista’s role and skill became less obvious. As Schultz lamented in his 2007 memo, much of the “romance and theatre” that took place behind Starbucks counters was lost.

In early 2008, the coffee company renewed its commitment to the skills and knowledge of its baristas in a very public way. In February, a little more than a month after Schultz returned to the helm of the company, Starbucks announced that for the first time since its founding it would close down more than 7,000 of its American stores to re-train employees in the art of “espresso excellence.” At 5:30 on a Tuesday evening, Starbucks partners across the country gathered for more than three hours to practice drawing espresso shots and steaming milk and to discuss their techniques in groups. In March, at the annual meeting, Schultz’s announcement that the company would transition to a new espresso machine, one that gave baristas more of an opportunity to use and showcase their skills, added to the sense that Starbucks was taking measures to reaffirm and revitalize its original coffee culture.

Marketing

The importance of human connection extended from the company’s management to its partners to its marketing initiatives. On the face of it, the company was selling coffee. But the premise underlying the marketing strategy had always been that the in-store experience lay at the heart of Starbucks success. The interactions between partners and customers in each store, which were driven by the connection between partners and the organization, distinguished Starbucks business from others. Marketing initiatives were therefore created and implemented to enable consumers to get to know Starbucks through the individuals who made it run.

This objective was evident in the types of marketing strategies the company had historically pursued. Campaigns tended to be high-touch, low-reach efforts that relied on word-of-mouth; most of these were community-based. For example, to launch the 2006 holiday season, Starbucks handed out subway passes in New York City, paid for taxi fares in Boston and San Francisco, and sponsored rides on a holiday carousel in Seattle. This strategy was radically different from that pursued by many retail and consumer products companies, which tended to invest heavily in mass advertising and product placement. In 2006, for instance, McDonald’s spent about $60 million on advertising for its coffee line alone, while Starbucks total advertising expenditures that year totaled $37.9 million.
In late 2007, however, the coffee company broke with its longstanding strategy, launching its first national television campaign that November. A few months later, it ran a print ad for the Got Milk? campaign highlighting the nutritional value of a milk-rich latte. These efforts were followed in early 2008 by coupons for tall-size Pike Place coffees placed in several major national newspapers. Experts estimated that total marketing expenditures for the company in 2008 would approach $100 million, up from $50 to $70 million in recent years.

The extent and expense of these mass-market outreach efforts were unusual for the firm, reflecting its response to the first-ever drop in same-store sales and customer traffic and a decline in the company’s profits. The economy was one factor in this drop, especially in U.S. markets, such as southern California, that had been most affected by the real-estate bubble. But the dips in sales, traffic and profits also came after an exceptionally long run of gains. As early as the mid-1990s, analysts had been predicting that Starbucks could not sustain such strong growth, especially in same-store sales. For more than 10 years, Starbucks had consistently beaten these expectations, even during the market slump of 2001. By 2008, however, Starbucks unprecedented size, combined with the uncertainty of the economy, had placed the company in a new competitive game. “No brand follows a steady, straight line in terms of sales, profits and brand loyalty,” said Scott Bedbury, a former Starbucks marketing executive. “This is a brand revitalization in the face of a difficult economic period that doesn’t look like it’s abating anytime soon.”

Starbucks foray into more traditional advertising channels was necessitated in part—and perhaps ironically—by the success of its original strategy. By 2007, most consumers already knew about the brand, and millions enjoyed its products. The market for gourmet coffee had expanded dramatically since Starbucks early years and continued to grow at a healthy pace. For consumers who had come to view the latte as a daily necessity rather than an occasional treat, Starbucks was seen as a natural destination. But these achievements had not been enough to stave off the company’s first decline in same-store traffic. At the same time, the word-of-mouth advertising that had fueled the company’s organic growth in its early years, when lattes were still a novelty and the chain of stores was relatively small, no longer seemed to have the same potency. As the coffee company pursued a robust growth strategy in a difficult economy, company leaders realized that casual buzz alone might not be enough to spread the Starbucks message. Did word-of-mouth have a natural lifecycle? How could an offering—a product, an experience, a service—remain novel and thus appealing on those terms? These were some of the issues that confronted Schultz and his team.

Another problem facing the marketing organization was the popularity of the brand itself. As the brand’s reach and power had grown, so, too, had a small, vocal chorus of company critics, including media pundits and activists of various stripes. In the United States, the company’s perceived ubiquity had become the subject of media jokes and anti-Starbucks websites. In 1998, the humor publication The Onion published a story with the headline, “New Starbucks to Open in Restroom of Existing Starbucks,” and in 2006 the comedian Andy Borowitz posted an article about Starbucks planned expansion to the moon. The website www.ihatestarbucks.com offered a public forum for negative commentary. (The site’s owner removed pro-Starbucks postings.) Another site, www.delocator.net, provided a listing of independent coffee houses for consumers seeking an alternative to Starbucks.

The company was also criticized by nutritionists for its increasing popularity among children and teenagers. Starbucks line of non-coffee based blended beverages in fruit, cream, and tea flavors were favored by teenagers, an important part of the company’s expanding customer base. But critics pointed out that these items were also high in calories and fat. For example, a Starbucks grande Strawberries & Crème Frappuccino® had 570 calories and 15 grams of fat, and some of the venti Frappuccino drinks had over 700 calories. Groups such as the Center for Science in the Public Interest, an organization that advocated for issues related to nutrition, threatened campaigns that
would link Starbucks products to major health problems in the United States. In response, Starbucks took several steps to educate consumers and improve the nutritional content of its food and beverage offerings. In 2007, the company announced it would eliminate artificial trans fats in all North American stores by the end of the year and would eventually remove the ingredient from all stores worldwide. Starbucks also posted signs in stores indicating “lighter options.”

Outside the United States, Starbucks tailored its marketing tactics to a diverse mix of cultures and consumers, and the most successful international launches continued to set off an excitement over the brand that was evocative of the company’s early years. This was equally true in countries where a Starbucks latte represented an exotic curiosity and in nations, such as England, where American brands and caffeinated beverages were common fare. In 2008, The Times of London noted: “In Mexico City, Starbucks stores attract the young, the beautiful and the affluent. Consumers in Jakarta proclaim their pride in being able to drink the same cup of coffee as the country’s wealthiest people... Kuwaitis like the dating scene, especially since the sexes almost never get to intermingle in public otherwise.” Starbucks had even managed to alter the tastes of tea-drinking consumers in Britain, noted the same article. In the years after 1998, when Starbucks first entered the United Kingdom, tea sales fell even as coffee sales flew upward. By 2005, Starbucks national market share was larger than any other coffee chain. By 2008, annual coffee sales in Britain exceeded sales of tea.

In many parts of Asia, where tea was also the traditional drink of choice, Starbucks trendy image attracted throngs of consumers to its stores. Its clean, spacious store interiors were markedly different from many cafés or tea stalls in Japan, Malaysia, or Thailand, where smoking was common and seating was often crowded. More important, its espresso drinks were nothing like the instant coffee that was common in many parts of the region. “I never liked coffee before, but it tastes really good here,” said Mami Taneda, a Starbucks customer in Tokyo. In addition, the company attracted interest through offerings that were tailored to local markets and supported communities in the region. In Malaysia in 2004, for instance, Starbucks offered Muan Jai, a blend grown in Thailand, and Komodo Dragon, a blend originating from Sulawesi in Indonesia. Five percent of the sales from both these blends were given back to the farmers to support agricultural education and activity.

Not all international reactions to Starbucks expansion were friendly, however. In some markets, the very power and visibility of the brand led to charges of American cultural imperialism. In China, for example, Starbucks store in the Forbidden City, the former imperial palace in Beijing, had been a flashpoint for criticism since its opening in 2000. Seven years later, the company decided to close the controversial outlet. In Italy, in 2007, the National Institute for Italian Espresso certified a version of the traditional Italian cappuccino consisting of a shot of espresso covered with frothy, steamed milk and served only in small ceramic cups. Some commentators suggested this act was aimed at countering the spread of Starbucks stores with their large, milky coffee drinks served in paper cups. And in Lebanon, Starbucks stores were boycotted by opponents of the United States’ war on Iraq, even though the company’s local partner and the operator of the stores was an Arab-owned firm.

Starbucks believed that its global expansion allowed it to make a valuable contribution to local communities worldwide. Most consumers seemed to agree and perceived Starbucks in positive—often very enthusiastic—terms. But there were discrete, virulent pockets of discontent, and some of these individuals and groups were outspoken in their opposition to the company’s growing presence. They viewed Starbucks as an unwelcome global behemoth that threatened, rather than fostered, the survival of local cultures. The challenge for Starbucks was to address the concerns of these critics while simultaneously capitalizing on the company’s strong consumer goodwill and deep-seated ties within local communities.
Operations

Starbucks had built and maintained an organization that was much more vertically integrated than many of its competitors and indeed many companies more generally. By the end of the twentieth century, relatively few young corporations were structured in a way that enabled centralized control over virtually the entire value chain. Business models that incorporated strategies for risk-sharing and cost-efficiency, such as decentralization and outsourcing, were much more common. By contrast, Starbucks controlled nearly every aspect of the processing and distribution of its products. Its leaders pursued such a tightly-knit structure in order to maintain control of the coffee beans, the people, and other tangible and intangible ingredients that made up the brand. (In this respect, Starbucks was more like companies founded in the late nineteenth century, such as H.J. Heinz, that created strong brands based on vertical integration and tight quality control, than like most of its peers.)

From the gate of the coffee farm to the door of the retail store, Starbucks was directly involved with each step of the value-creation process. At the top of the chain, the company’s managers travelled to coffee-growing regions in East Africa, Latin America, and Southeast Asia to personally choose the beans used in its beverages. In addition to selecting high-quality beans, Starbucks exerted significant influence over its suppliers in terms of sustainability practices and the treatment of farm workers. To this end, it provided farmers in Central America with a support center staffed by agronomists and sustainability experts, and had plans to introduce similar activities in East Africa. Further along the chain, once the raw harvest was purchased, it was roasted in company-owned facilities and shipped the product to stores in special FlavorLock bags. To ensure that the resulting brews satisfied company standards, Starbucks continually evaluated them. In 2006, company representatives tasted about 1,000 cups of coffee per day.

Moving down the value chain to the store level, the company exercised even more control. From the beginning, Schultz and his colleagues had recognized the importance of the store experience and had sought to create and sustain this in myriad ways. One of the most significant was the decision not to franchise Starbucks stores; indeed in the early years, the coffee company owned every unit outright (the company later pursued licensing agreements for stores in commercial locations such as airports, grocery chains, and hotels). Historically, the design of Starbucks stores was also highly centralized. Most store designers were located in the company’s Seattle headquarters and worked to create a consistent look and feel across all locations.

Owning and operating its own stores allowed Starbucks to train and communicate directly with its partners on the front line. The coffee company had long recognized that baristas played a vital role in shaping the customer experience and ensuring that each patron moved through the store efficiently and pleasurably. In the 1990s, as Starbucks increased the scale and breadth of its product offerings, managers and front-line employees saw that the expanded menu disrupted the animating interactions, and thus collective energy, in stores. For example, many of the new iced and espresso-based drinks required several steps of preparation, which made the barista’s job more complex and lengthened the typical customer’s wait in line. The company realized that it would have to make major changes to its operating procedures in order to maintain its performance levels.

In 2000, Starbucks took an initial step in this direction by creating an industrial-engineering division led by Silvia Peterson, an engineer with a background in fast-food restaurants. Peterson and her team were charged with identifying ways to decrease the time it took customers to receive their drink orders. Based on the group’s research, Starbucks altered store operations in several ways. For instance, signatures were no longer required on credit-card purchases under $25. “Floaters” were assigned to handle unpredicted tasks that threatened to slow down service, such as retrieving extra coffee beans from storage areas and taking the drink orders of customers waiting in line. The
company also started using semiautomatic espresso machines in place of the manual La Marzoccas and pre-sized ice scoopers for frozen drinks. The new system increased the efficiency with which baristas could deliver drinks to waiting customers. The floaters reduced overall service time by 20 seconds, the new espresso machines cut 24 seconds off the time it took to draw a shot, and the pre-sized ice scoopers reduced the preparation time for blended beverages by 14 seconds.

While the changes allowed Starbucks to handle a greater amount of traffic, they also made the barista job more routine and made the store environment seem potentially more sterile and homogenous. For example, the semiautomatic espresso machines eliminated much of the coffee aroma that had infused Starbucks stores and had contributed to their traditional café atmosphere. The machines also gave baristas less opportunity to use their skills in drawing espresso shots, which many considered a special talent. Moreover, even with the new operational processes, less than 60% of stores met the company’s goal of serving each customer within three minutes or less. As a result, executives were considering further innovations, such as the use of an automatic ice dispenser that would eliminate scooping entirely and an automatic syrup dispenser for Frappuccinos.

Mindful of the ways that these changes could affect the overall experience of customers as well as partners, executives tried to balance practices to improve efficiency with efforts to preserve the appeal and individuality of each store. “You don’t want customers to feel they’re in an Indy-500 pit stop,” explained Alling. To handle current volumes of traffic in Starbucks stores, however, the company needed to use some form of automated or semi-automated espresso machines. The manual machines, while charming, were simply not fast enough to keep up with customer orders; moreover, the repetitive labor that they required had also caused some partners to develop carpal tunnel syndrome. Company leaders hoped that the new machine, the Mastrena, would give baristas the speed of previous automated machines balanced by the opportunity to use their espresso-drawing skills.

To counter increasing standardization in operations, the company also began altering the store design process. Starbucks had traditionally decorated all stores in a similar fashion—the walls were painted in earth tones and hung with coffee motifs, and the floors were studded with comfortable, oversized chairs. But in 2004, Starbucks decided to locate designers in regional offices and encouraged them to incorporate architectural and design elements from the local neighborhoods in which stores operated. In Chicago, for example, Starbucks opened a store in a historic building that had once housed a Christian Science Reading Room. Designers retained the original fireplace mantel as well as building’s original doors and columns and created a curved interior wall in order to preserve a bay window. They also placed reading lamps on the tables and covered the floor with rugs to evoke the building’s past. A New York City store displayed vintage photographs of the location that a member of the store development team had retrieved from city archives. And designers of a Portland, Oregon, store added an outside counter to accommodate the many customers in the neighborhood who came to Starbucks with their dogs.

Living the Mission

Beyond taking care of partners and developing personal relationships with customers, Starbucks mission included a broader commitment to being a responsible corporate citizen. Early in its history the company led projects to aid the coffee-growing community and preserve the environments surrounding coffee farms. In 1991, it began working with CARE, an international humanitarian organization dedicated to fighting global poverty. In 1992, it adopted an environmental mission statement that emphasized the use of ecologically responsible products. The Starbucks Foundation,
established in 1997, supported the company’s many projects in communities where Starbucks had stores and purchased raw materials for coffee, tea, and cocoa.\textsuperscript{178}

By 2007, the company’s corporate social responsibility (CSR) efforts had developed to span a wide range of activities. These each fell within one of three major areas: literacy and community development, the environment, and support for the farmers who supplied the company’s coffee beans, tea, and chocolate. The company had chosen to concentrate on these areas because executives believed they were closely related to the business’s success and were also an integral part of the organization’s identity and animating principles.

One of the most important avenues for Starbucks outreach was its financial and educational support for farmers. Starbucks paid its coffee suppliers an average of 23\% over market prices, and in some years the premium was substantially higher.\textsuperscript{179} It was in the company’s interests to support the development of high-quality coffee production, but Starbucks leaders also believed that the company had a responsibility to help improve the quality of life in the coffee-farming areas upon which its success depended. Starbucks work with Conservation International was one example of the company’s commitment to supporting its suppliers. Another was its partnership with the African Wildlife Foundation to promote coffee quality, environmental sustainability, and natural resource conservation in East Africa.\textsuperscript{180} “We’re trying to do our part to give back to the people of the regions in which we buy coffee,” said Schultz. “You don’t do these things for recognition, you do these things because they are the right thing to do.”\textsuperscript{181}

Starbucks environmental initiatives stemmed from a conviction that the company had an obligation to minimize its global footprint. In fact, a lack of action on such issues as global warming, energy use, water and soil quality, and biodiversity could jeopardize the quality of coffee farms and thus the industry’s future. Company efforts to address climate change included the 2006 introduction of a new paper drinking cup with 10\% post-consumer recycled fiber. The cup reduced the amount of wood Starbucks used by 11,300 tons in the first year alone—equivalent to 78,000 trees.\textsuperscript{182} Starbucks had also been recognized by the U.S. Department of Energy for its approach to wind power, and in 2006 the company quadrupled its renewable energy purchases to a total of 20\% of the energy used in its North American stores.\textsuperscript{183}

A similar rationale underlay Starbucks efforts in literacy and community development. In a program called “Make Your Mark,” for example, Starbucks matched partner and customer volunteer hours with financial contributions to nonprofit organizations.\textsuperscript{184} Beyond the contribution volunteers made to the service projects on which they worked, partners and customers participating in the Make Your Mark program were likely to develop the types of personal relationships and human connections that the senior team believed were central to the “Starbucks Experience.” In this way, the program had a business as well as a charitable purpose.

\textit{Visible Target}

Starbucks social initiatives did not make it immune to the censure of anti-globalization, environmental, labor, health, and other special interest groups. “I remember the early days,” said Schultz. “We were revered as the underdog and the small company. And now we’re not a small company. We’re large and ubiquitous, and as a result, we’re a target.”\textsuperscript{185} But the reaction against Starbucks had to do with more than the company’s size. Starbucks was one of a few large corporations that had proclaimed its values and told stakeholders that it intended to be a responsible citizen. This position, and the public nature of Starbucks longstanding commitment, raised expectations for the firm’s behavior and increased the likelihood that activists would select it as a target.
By the early twenty-first century, Starbucks had been taken to task—at times, loudly and prominently—for not doing enough on issues ranging from support for coffee growers in developing countries to employee rights in its U.S. stores. Starbucks size meant that these attacks almost always attracted attention—often significant attention. Some of this publicity threatened to dilute the company’s brand, confusing consumers, employees, and other stakeholders about a central aspect of Starbucks identity. Many partners at all levels wanted to carry out the mission that Starbucks had espoused from its days as a small firm as effectively as possible. At the same time, the organization had to generate new standards as the expectations of partners, consumers, and other stakeholders evolved. But no matter how high it set the bar, the coffee company could not please everybody.

Supplier relations were a particular focus for activists. In 2000, the human rights group Global Exchange pressured the company to offer Fair Trade Certified™ coffee in its stores. Fair Trade Certified producers were guaranteed a minimum, “fair” price for their goods that was usually higher than market average. In April of that year, Starbucks agreed to begin purchasing some of its coffee from Fair Trade suppliers. In 2001, it introduced its own socially responsible coffee-buying guidelines, called Coffee and Farmer Equity (C.A.F.E.) practices. By 2006, Starbucks was the largest purchaser of Fair Trade coffee in North America; 6% of its coffee was Fair Trade and 53% was purchased from suppliers who followed C.A.F.E. practices. (As the company grew, it became difficult to find enough suppliers of high-quality coffee beans who complied with the social and environmental standards of either system.) But Global Exchange remained critical of Starbucks purchasing practices. “The implementation of the C.A.F.E. practices in no way reduces our initial and still unmet demands,” the organization announced. Its website warned that there was “no guarantee that coffee without the Fair Trade seal is not sweatshop coffee.”

Other activists aired complaints about the dairy farms that supplied Starbucks with milk for its drinks. In 2001, the Organic Consumers Association (OCA) launched a campaign against Starbucks to protest the use of dairy products containing genetically modified ingredients. In particular, the OCA objected to milk produced by cows that had been injected with a growth hormone called rBST (recombinant bovine somatotropin). Demonstrators referred to the company as “Frankenbucks” and staged demonstrations across the United States. OCA President Ronnie Cummin announced that his organization aimed “to affect [Starbucks] worldwide image and bottom line.” In 2007, Starbucks agreed to phase out all dairy products made with the growth hormone, and the transition was completed in January of 2008.

In addition to continued protests over hormone-free dairy products and Fair Trade coffee, Starbucks dealings with Ethiopian farmers were followed closely. In 2006, the Ethiopian government sought trademarks for several varieties of coffee beans sold in Starbucks stores. The beans, from regions in the country such as Sidamo, Harar, and Yirgacheffe, were highly regarded by coffee connoisseurs and consumers alike. Activists believed that securing a trademark for these names would potentially allow poor farmers to earn royalties from the sale of their products, and accused Starbucks of blocking the efforts in an attempt to avoid sharing profits with the Ethiopian people. Oxfam, a large international development and humanitarian aid agency, made the argument public through full-page advertisements in The New York Times and two Seattle-area newspapers. Starbucks dealings with Ethiopian farmers were also the subject of Black Gold, a 2006 film that offered a powerful critique of the global coffee industry.

Starbucks executives believed the company was already giving significant support to farmers, and they thus resisted activists’ repeated calls to recognize the Ethiopian trademarks. The company paid premium prices for Ethiopian coffee—28% above market—invested in education and environmental initiatives in the country, and made development loans to coffee farmers. However, the company’s existing initiatives were not enough to satisfy many activists; in March 2007 some angry opponents of
the company staged a protest at the annual shareholders meeting. The issue was finally resolved three months later when Starbucks announced an agreement with the Ethiopian government for the licensing, marketing, and promotion of the country’s coffee beans. By the conclusion of this episode, it was clear that even in areas in which the company had voluntarily taken steps to address social issues, activists would not be easily appeased.

Starbucks relations with employees represented another area that drew the ire of activists despite—or perhaps because of—the company’s relatively generous benefits. In the United States, the company was the target of organizers from the Industrial Workers of the World (IWW), a socialist labor union. Starbucks partners in several New York stores and one Chicago store joined the IWW in 2005 and 2006, and group organizers began targeting Starbucks social commitments and the links to the brand. “We’re going to escalate our outreach to workers, and pierce the socially responsible image that the company has so skillfully promulgated around the world,” one union organizer told reporters. In a complaint to the National Labor Relations Board (NLRB), the union alleged Starbucks was engaging in unfair labor practices, including wrongful termination of union supporters. In early 2007, the NLRB issued a statement charging Starbucks with 30 counts of illegal activity at four New York stores. A Starbucks spokesperson characterized the allegations as “baseless” and announced the company would “vigorously defend” itself in court. As of May 2008, the dispute remained unresolved.

The company’s reluctance to settle the case was due in large part to executives’ beliefs that they treated partners fairly and offered more and better benefits than those available in most frontline retail jobs. But the company’s record in fighting other labor-related charges showed that it was sometimes vulnerable to attack. In October 2007, Starbucks settled a case with the IWW over union-organizing efforts at a store in Grand Rapids, Michigan, after the NLRB ruled that the complaints might have a basis in law. A few months later, it came to an agreement with a group of assistant managers who alleged that they had been forced to work off the clock. In March 2008, a judge in California ruled against the company in a suit alleging that shift supervisors had illegally shared baristas’ tips, ordering it to distribute $86.7 million, plus interest, among the affected workers. The continued instances of labor unrest, like the Ethiopian trademark dispute, suggested that there was a substantial disconnect between the internal view of Starbucks social responsibility and the way the company was perceived by specific, potentially influential bands of critics.

Telling the Starbucks Story

Schultz speculated that some of the company’s challenges from activist critics stemmed from a lack of communication. “Many of these groups are ill-informed about Starbucks,” he explained. “If people kind of got underneath the company and looked at all we do, maybe they’d have a different view.”

In its early years, Starbucks had done little to publicize its social initiatives. The company assumed that consumers would be aware of what Starbucks was doing in its global supply chain and environmental programs. Broadcasting these efforts seemed unnecessary and perhaps even inappropriate. But mounting activist criticism led to a change in strategy, and in the early twenty-first century, Starbucks adopted a more proactive stance. For example, the company dedicated a section on its web site to “rumor response,” where it posted press releases about issues such as the Ethiopian coffee trademark dispute. In addition, the company decided to enrich its commitments to programs that addressed social issues on a worldwide level with local actions in communities across the United States. For example, Starbucks stores organized groups of customers and partners to clean up local parks, and they donated coffee or money to community groups.
Starbucks was also starting to take its message to other groups besides consumers. In 2005, for example, the company launched a program called “Voices Behind the Bean,” which was designed to inform journalists as well as consumers about the range of people working in the Starbucks supply chain, from coffee farmers all the way to the baristas in its stores. As part of the program, Starbucks took journalists to meet with coffee farmers and exporters in Costa Rica. For other interested parties, there were cards and videos that told the stories of individual farmers.203

Comprehensive data about Starbucks initiatives was available to all the company’s stakeholders in its CSR Annual Report. The report detailed Starbucks sourcing standards for products, contributions to local communities, environmental commitments, workplace practices, and diversity initiatives. Metrics in each dimension showed how the company had performed relative to the previous year. For instance, the 2006 report recorded the percentage of coffee that came from Fair Trade and C.A.F.E. providers, the number of hours that Starbucks partners volunteered, the percentage of recycled paper used in Starbucks paper products, the engagement level of Starbucks partners, and the representation of women and minorities among Starbucks executives and suppliers.

Starbucks public disclosures were part of a broader effort by the company to tell its story to relevant constituencies, including the media, nongovernmental and governmental organizations, as well as employees, investors, and consumers. But communications issued through official reports, press releases, and marketing materials could only offer information from Starbucks point of view. They were not designed to allow consumers or other stakeholders to respond to the company’s policies and strategic decisions. As such, these materials ran the risk of being perceived as one-sided and thus inauthentic. MyStarbucksIdea.com, the interactive web site that Schultz unveiled at the 2008 annual meeting, was the first interactive forum in which customers, partners, and other stakeholders could exchange ideas, comments and criticisms about the organization with specific representatives of the company. It was the first medium that allowed Starbucks to participate in the conversations that many investors and Starbucks fans were already having—both online and off—about the future of the company. Some of the results of this ongoing dialogue quickly became part of the company’s strategy.

MyStarbucksIdea.com allowed anyone with Internet access to register and post suggestions on its message boards about Starbucks products, the customer experience in its stores, and the company’s involvement with regard to communities and social responsibility. Members of the online community could also comment on suggestions and cast their votes for the best ideas. In the first few months of operation, the site attracted hundreds of suggestions and thousands of customer comments. Starbucks partners responded to the comments, clarified Starbucks policies when controversy arose, and placed the most popular ideas under review for future implementation. A separate blog on the web site called “Ideas in Action” showed the items that the company was already considering or putting into practice. In late March 2008, for instance, Starbucks agreed to eliminate store receipts for purchases under $25, a move that consumers had suggested to help the company reduce its paper waste. The company was reviewing several other ideas, including a larger discount for customers who used personal mugs, which would encourage more people to give up disposable cups, and smaller portion sizes for pastries so that consumers could indulge in lower-calorie snacks.

A Higher Bar

Starbucks commitments to all of its stakeholders led the company to pursue ambitious financial and social objectives. However, managing the often conflicting demands of Wall Street investors on the one hand and socially conscious partners, consumers, activists, and citizens on the other, was not always easy. Starbucks identity was wrapped up in the coffee culture that it had helped to spread throughout the United States and around the world, and in the farmers, roasters, baristas, and others
who helped bring its unique blends to the consumer palate. In the short run, the company could boost its financial performance by cutting back on support to some of these stakeholders. But in the long run, it believed that doing “the right thing” would also lead to financial success. “The road is paved with so many companies that have lost their way through thinking that they can be all things to all people,” said Schultz. “The strength of [Starbucks] brand and the success of our company is linked to our focus and discipline. We’ll continue to be a coffee company. That’s who we are.”

Starbucks was not alone in its commitment to both social and financial performance, nor in the difficulties it faced in executing this agenda. Organizations such as Whole Foods Market, Timberland, The Body Shop, and others also aspired to bridge or even eliminate the perceived divide between commercial gain and positive social impact. Organic grocer Whole Foods, for example, had made natural foods widely available to mainstream American shoppers, encouraged the development of sustainable farming practices, and influenced the way consumers thought about their own health and wellbeing. At the same time, the grocery retailer had generated a substantial return for shareholders, with the stock price increasing over 1,000% from the company’s initial public offering in 1992 through the start of 2007. Like Starbucks, Whole Foods had ramped up expansion efforts during this time and had consequently come under attack from animal rights groups, labor unions, and advocates of small-scale, local production.

Starbucks, Whole Foods, and other organizations had been on the cutting edge in embracing dual agendas. But increasingly, consumers themselves were demanding such business models from the companies they patronized. A new breed of customers expected that firms would do more than simply generate a profit without regard to the costs—social, economic and environmental—of that pursuit. With mounting intensity, buyers from many walks of life were insisting that the businesses they patronized give employees a fair deal, including a living wage and benefits. They also wanted companies to make credible sustain social and environmental commitments at all points along the supply chain—from the labor practices of suppliers in developing countries to use of natural and organic ingredients in food products and the adoption of green building techniques in retail locations. For businesses across the spectrum, growing consumer awareness translated into an intensifying scrutiny and ongoing pressure for improvement and potentially, redefinition.

Many questions remained unanswered about how Starbucks could continue to grow rapidly while pursuing its broader social mission. The way forward was uncharted, and older, well-trodden business paths provided no clear direction. But the potential impact that Starbucks and other, similar organizations could have was enormous, and the issues they raised pressing: Would these companies be able to create a new standard for how businesses interacted with their stakeholders? Could they continue to be seen as visionaries, or would the bar they set be swiftly surpassed by rising consumer expectations? At a time when most governments around the world lacked sufficient resources to tackle public problems, what role would committed, socially responsible businesses assume on the larger stage?

To accomplish its social goals—whatever form these might take in the future—Starbucks had to remain financially successful. In the near term, the company had many assets at its disposal to help weather economic uncertainty. Prime examples were its powerful brand, loyal customers, a stepped-up marketing campaign, and a focus on the new Pike Place brewed coffee, a beverage that was less expensive and potentially more accessible than espresso drinks. Starbucks performance in the long term, however, was harder to gauge. Would expanding at a slower rate and with more precision, focusing on specific markets abroad, be enough to satisfy the financial markets? Would it give the company the momentum it needed to move forward? If not, what kind of choices would the firm’s senior leadership face?
After 15 years of breakneck growth, buoyant stock prices, and rewarding work on social and environmental fronts, Starbucks found itself at a crossroads. The novelty and heady excitement of the company’s early years would most likely be hard to match in the future. How, then, should the company define success? Starbucks was no longer regarded as a scrappy underdog in the emerging market of specialty coffee. It had become the company to beat, and its strategies, including its social commitments, were widely copied by competitors. Going forward, company leaders had to rethink Starbucks path and place in the world markets. More broadly, they had to reconsider the company’s very identity. What factors would drive its financial success? What goals would motivate its workforce? What role would the mission play, not only terms of partner engagement, but also externally, as customers increasingly evaluated the brand’s authenticity? How would it evolve while remaining true to its core values? What kind of company would it become?
Exhibit 1  Memo from Howard Schultz

From: Howard Schultz


To: Jim Donald

Cc: Anne Saunders; Dave Pace; Dorothy Kim; Gerry Lopez; Jim Alling; Ken Lombard; Martin Coles; Michael Casey; Michelle Gass; Paula Boggs; Sandra Taylor

Subject: The Commoditization of the Starbucks Experience

As you prepare for the FY 08 strategic planning process, I want to share some of my thoughts with you.

Over the past ten years, in order to achieve the growth, development, and scale necessary to go from less than 1,000 stores to 13,000 stores and beyond, we have had to make a series of decisions that, in retrospect, have led to the watering down of the Starbucks experience, and, what some might call the commoditization of our brand.

Many of these decisions were probably right at the time, and on their own merit would not have created the dilution of the experience; but in this case, the sum is much greater and, unfortunately, much more damaging than the individual pieces. For example, when we went to automatic espresso machines, we solved a major problem in terms of speed of service and efficiency. At the same time, we overlooked the fact that we would remove much of the romance and theatre that was in play with the use of the La Marzocca machines. This specific decision became even more damaging when the height of the machines, which are now in thousands of stores, blocked the visual sight line the customer previously had to watch the drink being made, and for the intimate experience with the barista. This, coupled with the need for fresh roasted coffee in every North America city and every international market, moved us toward the decision and the need for flavor locked packaging. Again, the right decision at the right time, and once again I believe we overlooked the cause and the affect of flavor lock in our stores. We achieved fresh roasted bagged coffee, but at what cost? The loss of aroma -- perhaps the most powerful non-verbal signal we had in our stores; the loss of our people scooping fresh coffee from the bins and grinding it fresh in front of the customer, and once again stripping the store of tradition and our heritage? Then we moved to store design. Clearly we have had to streamline store design to gain efficiencies of scale and to make sure we had the ROI on sales to investment ratios that would satisfy the financial side of our business. However, one of the results has been stores that no longer have the soul of the past and reflect a chain of stores vs. the warm feeling of a neighborhood store. Some people even call our stores sterile, cookie cutter, no longer reflecting the passion our partners feel about our coffee. In fact, I am not sure people today even know we are roasting coffee. You certainly can't get the message from being in our stores. The merchandise, more art than science, is far removed from being the merchant that I believe we can be and certainly at a minimum should support the foundation of our coffee heritage. Some stores don't have coffee grinders, French presses from Bodum, or even coffee filters.

Now that I have provided you with a list of some of the underlying issues that I believe we need to solve, let me say at the outset that we have all been part of these decisions. I take full responsibility myself, but we desperately need to look into the mirror and realize it's time to get back to the core and make the changes necessary to evoke the heritage, the tradition, and the
passion that we all have for the true Starbucks experience. While the current state of affairs for the most part is self induced, that has led to competitors of all kinds, small and large coffee companies, fast food operators, and mom and pops, to position themselves in a way that creates awareness, trial and loyalty of people who previously have been Starbucks customers. This must be eradicated.

I have said for 20 years that our success is not an entitlement and now it's proving to be a reality. Let's be smarter about how we are spending our time, money and resources. Let's get back to the core. Push for innovation and do the things necessary to once again differentiate Starbucks from all others. We source and buy the highest quality coffee. We have built the most trusted brand in coffee in the world, and we have an enormous responsibility to both the people who have come before us and the 150,000 partners and their families who are relying on our stewardship.

Finally, I would like to acknowledge all that you do for Starbucks. Without your passion and commitment, we would not be where we are today.

Onward…

Exhibit 2  Chronology, 2000-2007

2000  – Orin Smith promoted to President and CEO, replacing founder Howard Schultz. Schultz remains Chairman and assumes new position of Chief Global Strategist.
– Starbucks agrees to market and sell Fair Trade Certified coffee through licensing agreement with TransFair USA.
– Starbucks Coffee International opens in Dubai, Hong Kong, Shanghai, Qatar, Bahrain, Saudi Arabia, and Australia.
– Total locations: 3,501.

2001  – Introduces high-speed wireless internet access in select store locations.
– Commits to buying one million pounds of Fair Trade Certified coffee, offers $1 million in support to coffee farmers, and introduces coffee sourcing guidelines.
– Starbucks Foundation awards over $4.2 million in grants to literacy, schools, and community organizations in North America. Company announces $1 million philanthropic partnership with Jumpstart.
– Introduces the Starbucks Card, a re-loadable store-valued card.
– Opens 300th location in Japan. Starbucks Coffee International opens in Switzerland, Israel, and Austria.
– Building initiated for third roasting plant, in Carson, Nevada.
– Total locations: 4,709.

– Introduces Starbucks DoubleShot.
– Initiates the Starbucks Make Your Mark volunteer program, which includes company-organized volunteer efforts and charitable contributions to organizations across North America.
– Starbucks Coffee International opens in Oman, Indonesia, Germany, Spain, Puerto Rico, Mexico, Greece, and Southern China.
– Total locations: 5,886.

2003  – Starbucks Card Duetto Visa introduced. Combines credit card and re-loadable store card functionality.
– High speed wireless service, T-Mobile HotSpot now offered in over 2,700 Starbucks stores.
– Acquires Seattle Coffee Company, including Seattle’s Best Coffee® and Torrefazione Italia® brands.
– Starbucks Coffee International opens in Turkey, Chile, and Peru. 1000th Asia Pacific store opened in Beijing, China.
– Total locations: 7,225.

– Partnership with Conservation International extended to include $2.5 million loan fund for farmers.
– Launches in-store CD burning service for the creation of personalized CDs at the Starbucks Hear Music Coffeehouse in Santa Monica, California. Introduces 24-hour “Starbucks Hear Music” channel through alliance with XM Satellite Radio.
- Announces agreement with Jim Beam Brands Co. for development and marketing of a Starbucks-branded coffee liqueur.
- Initiates licensing agreement with Borders Books & Music® to open Seattle’s Best Coffee cafes in Borders stores.
- Total locations: 8,569.

2005
- Opens 1672 net new stores, including 735 new company-operated stores. CEO Orin Smith retires. Jim Donald, previously president of the U.S. division, promoted to CEO.
- Launches Starbucks Discoveries chilled coffee sold in convenience stores and introduces Green Tea Frappuccino in North America.
- Publishes C.A.F.E. (Coffee and Farmer Equity) standards.
- Acquires Ethos™ Water, a company dedicated to raising awareness about the lack of clean water in developing countries. Starbucks initiates sales of Ethos™ bottled water in its stores and expands Ethos’ investment in water access, sanitation, and hygiene education programs in developing countries. Ethos™ donates a portion of each sale of bottled water to humanitarian water programs.
- Starbucks Entertainment releases new albums from Herbie Hancock and Bob Dylan.
- Total locations: 10,241.

2006
- Opens 2,199 new stores. Announces long-term target of 40,000 stores worldwide, 20,000 of which will be outside the United States.
- Opens first stores in Brazil and Egypt.
- Introduces new ready-to-drink beverages including Strawberries and Crème and Iced Coffee, as well as new in-store Frappuccino drinks made with fruit juices and freshly brewed Tazo tea.
- Announces plan to roll out hot vending machines that will heat lattes on demand for customers.
- Through agreement with Lions Gate and 2929 Entertainment, initiates marketing and distribution of first feature film, Akeelah and the Bee.
- Announces plan to roll out new paper drinking cup with 10% post-consumer recycled fiber; expected to reduce Starbucks use of new tree fiber by five million pounds in calendar year 2006.
- Total locations: 12,440.
2007  – Opens 2,571 new stores, including first stores in Russia and Romania and 126 new locations in China.
– Expands lunch program to over 1,000 new stores, with lunch items now offered in over 70% of company-operated stores within the United States.
– Reaches over $1 billion loaded and redeemed by customers on reusable Starbucks Cards.
– Launches first national television campaign, focused on the 2007 holiday season.
– Forms Hear Music record label to work with artists and distribute recordings in Starbucks stores and traditional music channels. Former Beatles singer Paul McCartney signs on as first artist.
– Initiates partnership with Apple that enables customers to digitally download music from the online iTunes Music Store.
– Promotes second film, “Arctic Tale,” intended to increase awareness of climate change.
– Announces development and distribution agreement with The Hershey Company for a line of Starbucks-branded premium chocolate products.
– Extends partnership with the environmental volunteer organization Earthwatch Institute to include research on coffee farming in Costa Rica.
– Provides funding to CARE, a humanitarian and development organization, for an educational and economic support program in Ethiopian coffee-growing regions.
– Total locations: 15,011.

Source: Starbucks Corporation annual reports, website.
Exhibit 3  Starbucks Stores, 2001-2007

## Exhibit 4  Starbucks Worldwide Presence, 2007

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<th>Country</th>
<th>Total stores</th>
<th>Company-operated stores</th>
<th>Licensed stores</th>
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<td>15,011</td>
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### Exhibit 5  Financial performance, 2000-2007 (thousands of dollars)

<table>
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<tr>
<th>Year</th>
<th>Total Net Revenues</th>
<th>Operating margin</th>
<th>Net earnings</th>
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<tbody>
<tr>
<td>2000</td>
<td>2,177,614</td>
<td>9.7%</td>
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<tr>
<td>2001</td>
<td>2,648,980</td>
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<td>2002</td>
<td>3,288,908</td>
<td>9.6%</td>
<td>212,686</td>
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<td>2003</td>
<td>4,075,522</td>
<td>10.4%</td>
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<td>2004</td>
<td>5,294,247</td>
<td>11.5%</td>
<td>391,775</td>
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<td>2005</td>
<td>6,369,300</td>
<td>12.3%</td>
<td>494,370</td>
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<td>2006</td>
<td>7,786,942</td>
<td>11.5%</td>
<td>564,259</td>
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<tr>
<td>2007</td>
<td>9,411,497</td>
<td>11.2%</td>
<td>672,638</td>
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</table>


### Exhibit 6  Starbucks Stock Price versus S&P 500, 1992-2008*

* Adjusted for dividends and splits.

Source: Capital IQ, FT.com, Edgar Online Pro.
Exhibit 7  Starbucks Employees, 2000-2007

Endnotes


5 Brand New, p. 246.


19 Brand New, pp. 235-236.

20 Brand New, p. 236.

22 Brand New, pp. 236-238.

23 Brand New, p. 238.


37 “International Coffee & Tea, LLC,” Hoover’s (accessed May 12, 2008).


54 Capital IQ (accessed June 5, 2008).


57 Brand New, p. 233.

58 Brand New, p. 233.


Starbucks also licensed stores in markets within the United States, primarily in locations where a master concessionaire controlled retail space. For example, in airport terminals Starbucks licensed stores to Host Marriott Services. In 2006 there were 3,168 licensed stores in the United States operating segment and 2,170 in the international operating segment.


85 Brand New, p. 250.

86 Starbucks Corporation, Form 10-K, 2005, pp. 3-5.


124 Brand New, p. 240.

125 Howard Behar, quoted in Brand New, p. 230.

126 Brand New, p. 240.


*Brand New*, p. 228.


197 Starbucks faced far fewer labor-related cases than did chains of similar sizes, but over the years it had chosen to settle with some groups of workers.


206 Starbucks Coffee International is a subsidiary of Starbucks Corporation and the entity through which most international joint ventures are pursued.

207 Conservation International (CI) is a nonprofit organization that works to preserve biodiversity worldwide. Starbucks first established a relationship with CI in 1998, to promote environmentally friendly methods of growing coffee.