CASE 29

Starbucks in 2018: Striving for Operational Excellence and Innovation Agility

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Since its founding in 1987 as a modest nine-store operation in Seattle, Washington, Starbucks had become the premier roaster, marketer, and retailer of specialty coffees in the world, with over 28,200 store locations in 76 countries as of April 2018 and annual sales that were expected to exceed $24 billion in fiscal year 2018, ending September 30. In addition to its flagship Starbucks brand coffees and coffee beverages, Starbucks' other brands included Tazo and Teavana teas, Seattle's Best Coffee, Evolution Fresh juices and smoothies, and Ethos bottled waters. Starbucks stores also sold snack foods, pastries, and sandwiches purchased from a variety of local, regional, and national suppliers. In January 2107, Starbucks officially announced it would:

- Open 20 to 30 Starbucks Reserve™ Roasteries and Tasting Rooms, which would bring to life the theater of coffee roasting, brewing, and packaging for customers, include a coffee bar with a full menu of coffee beverages, space for a mixology bar serving traditional Italian cocktails, and an upscale Princi bakery—a newly created Starbucks subsidiary that featured fresh-baked artisanal Italian breads, sandwiches, and pastries. The Starbucks Roaster and Tasting Room stores were designed in an open, marketplace style to (a) showcase the theater of roasting Starbucks Reserve™ coffees and the baking and other food preparation activities ongoing in the Princi kitchen, (b) enable customers to engage with store personnel at the Reserve coffee bar and Princi counter, and (c) gather with friends either at community tables or in lounge areas around two fireplaces.
- Open 1,000 Starbucks Reserve stores worldwide to bring premium experiences to customers and promote the company's recently-introduced Starbucks Reserve coffees; these locations offered a more intimate small-lot coffee experience and gave customers a chance to chat with a barista about all things coffee. The menu at Starbucks Reserve stores included handcrafted hot and cold Starbucks Reserve coffee beverages, hot and cold teas, ice cream and coffee beverages, packages of Starbucks Reserve whole bean coffees, and an assortment of small plates, sandwiches and wraps, desserts, wines, and beer. There were four types of brewing methods for the coffees and teas.
- Transform about 20 percent of the company's existing portfolio of Starbucks stores into Starbucks Reserve coffee bars.

Exhibit 1 provides an overview of Starbucks performance during fiscal years 2010 through 2017.

COMPANY BACKGROUND

Starbucks Coffee, Tea, and Spice

Starbucks got its start in 1971 when three academics, English teacher Jerry Baldwin, history teacher Zev Siegel, and writer Gordon Bowker—all coffee aficionados—opened Starbucks Coffee, Tea, and Spice

EXHIBIT 1 Financial and Operating Summary for Starbucks Corporation, Fiscal Years 2010–2017 ($ in millions, except for per-share amounts)

INCOME STATEMENT DATA	Oct. 1, 2017	Oct. 2, 2016	Sep 27, 2015	Oct. 3, 2010
Net revenues:				
Company-operated stores	$17,650.7	$16,844.1	$15,197.3	$ 8,963.5
Licensed stores	2,355.0	2,154.2	1,861.9	875.2
Consumer packaged goods, foodservice, and other	2,381.1	2.317.6	2,103.5	868.7
Total net revenues	$22,386.8	$21,315.9	$19,162.7	$10,707.4
Cost of sales, including occupancy costs	$ 9,038.2	$ 8,511.1	$ 7,787.5	$ 4,458.6
Store operating expenses	6,493.3	6,064.3	5,411.1	3,551.4
Other operating expenses	553.8	545.4	522.4	293.2
Depreciation and amortization expenses	1,011.4	980.8	893.9	510.4
General and administrative expenses	1,393.3	1,360.6	1,196.7	569.5
Restructuring and impairments	153.5	—	—	53.0
Total operating expenses	18,643.5	17,462.2	15,811.6	9,436.1
Income from equity investees and other	391.4	318.2	249.9	148.1
Operating income	4,134.7	4,171.9	3,601.0	1,419.4
Net earnings attributable to Starbucks	$ 2,884.7	$ 2,817.7	$ 2,759.3	$ 945.6
Net earnings per common share — diluted	$1.97	$1.90	$1.82	$0.62
BALANCE SHEET DATA				
Current assets	$ 5,283.4	$ 4,757.9	$ 3,971.0	$ 2,756.5
Current liabilities	4,220.7	4,546.8	3,648.1	2,703.6
Total assets	14,365.6	14,312.5	12,416.3	6,385.9
Long-term debt (including current portion)	3,932.6	3,585.2	2,347.5	549.4
Shareholders' equity	5,457.0	5,890.7	5,818.0	3,674.7
OTHER FINANCIAL DATA				
Net cash provided by operating activities	$ 4,174.3	$ 4,575.1	$ 3,749.1	$ 1,704.9
Capital expenditures (additions to property, plant, and equipment)	1,519.4	1,440.3	1,303.7	440.7
STORE INFORMATION				
Stores open at year-end				
United States				
Company-operated stores	8,222	7,880	6,764	6,707
Licensed stores	5,708	5,292	4,364	4,424
International				
Company-operated stores	5,053	4,831	2,198	2,182
Licensed stores	8,356	7,082	3,309	3,545
Worldwide	27,339	25,085	23,043	16,858
Worldwide percentage change in sales at company-operated stores open 13 months or longer	3%	5%	7%	7%

*Starbucks' fiscal year ends on the Sunday closest to September 30.

Sources: 2017, 2016, and 2011 10-K reports.

in touristy Pikes Place Market in Seattle. The three partners shared a love for fine coffees and exotic teas and believed they could build a clientele in Seattle that would appreciate the best coffees and teas. By the early 1980s, the company had four Starbucks stores in the Seattle area and had been profitable every year since opening its doors.

Howard Schultz Enters the Picture

In 1981, Howard Schultz, vice president and general manager of U.S. operations for a Swedish maker of stylish kitchen equipment and coffeemakers based in New York City, decided to pay Starbucks a visit. He was curious why Starbucks was selling so many of his company's products. When he arrived at the Pikes Place store, a solo violinist was playing Mozart at the door (his violin case open for donations). Schultz was immediately taken by the powerful and pleasing aroma of the coffees, the wall displaying coffee beans, and the rows of coffeemakers on the shelves. As he talked with the clerk behind the counter, the clerk scooped out some Sumatran coffee beans, ground them, put the grounds in a cone filter, poured hot water over the cone, and shortly handed Schultz a porcelain mug filled with freshly brewed coffee. After only taking three sips of the brew, Schultz was hooked. He began asking questions about the company, the coffees from different parts of the world, and the different ways of roasting coffee.

Later, when he met with two of the owners, Schultz was struck by their knowledge about coffee, their commitment to providing customers with quality coffees, and their passion for educating customers about the merits and quality of dark-roasted, fine coffees. One of the owners told Schultz, "We don't manage the business to maximize anything other than the quality of the coffee."[1] Schultz was also struck by the business philosophy of the two partners. It was clear that Starbucks stood not just for good coffee, but also for the dark-roasted flavor profiles that the founders were passionate about. Top quality, fresh-roasted, whole-bean coffee was the company's differentiating feature and a bedrock value. The company depended mainly on word-of-mouth to get more people into its stores, then built customer loyalty cup by cup as buyers gained a sense of discovery and excitement about the taste of fine coffee.

On his return trip to New York, Howard Schultz could not stop thinking about Starbucks and what it would be like to be a part of the enterprise. Schultz recalled, "There was something magic about it, a passion and authenticity I had never experienced in business."[2] By the time he landed at Kennedy Airport, he knew in his heart he wanted to go to work for Starbucks. But it took over a year and multiple meetings and discussions to convince the owners to bring in a high-powered New Yorker who had not grown up with the values of the company. In Spring 1982, Schultz was offered the job of heading marketing and overseeing Starbucks' retail stores; he assumed his new responsibilities at Starbucks in September 1982.

Starbucks and Howard Schultz: The 1982–1985 Period In his first few months at Starbucks, Schultz spent most of his time in the four Seattle stores—working behind the counters, tasting different kinds of coffee, talking with customers, getting to know store personnel, and learning the retail aspects of the coffee business. In December, he began the final part of his training—that of actually roasting the coffee. Schultz spent a week getting an education about the colors of different coffee beans, listening for the telltale second pop of the beans during the roasting process, learning to taste the subtle differences among the various roasts, and familiarizing himself with the roasting techniques for different beans.

Schultz overflowed with ideas for the company. However, his biggest inspiration and vision for Starbucks' future came during the spring of 1983 when the company sent him to Milan, Italy, to attend an international housewares show. While walking from his hotel to the convention center, he spotted an espresso bar and went inside to look around. The cashier beside the door nodded and smiled. The "barista" behind the counter greeted Schultz cheerfully and began pulling a shot of espresso for one customer and handcrafting a foamy cappuccino for another, all the while conversing merrily with patrons standing at the counter. Schultz thought the barista's performance was "great theater." Just down the way on a side street, he went in an even more crowded espresso bar where the barista, which he surmised to be the owner, was greeting customers by name; people were laughing and talking in an atmosphere that plainly was comfortable and familiar. In the next few blocks, he saw two more espresso bars. That afternoon, Schultz walked the streets of Milan to explore more espresso bars. Some were stylish and upscale; others attracted a blue-collar clientele. Most had few chairs and it was common for Italian opera to be playing in the background. What struck Schultz was how popular and vibrant the Italian coffee bars were. Energy levels were typically high and they seemed to function as an integral community gathering place. Each one had its own unique character, but they all had a barista who performed with flair and there was camaraderie between the barista and the customers.

Schultz remained in Milan for a week, exploring coffee bars and learning as much as he could about the Italian passion for coffee drinks. Schultz was particularly struck by the fact that there were 1,500 coffee bars in Milan, a city about the size of Philadelphia, and a total of 200,000 in all of Italy. In one bar, he heard a customer order a "caffe latte" and decided to try one himself—the barista made a shot of espresso, steamed a frothy pitcher of milk, poured the two together in a cup, and put a dollop of foam on the top. Schultz liked it immediately, concluding that lattes should be a feature item on any coffee bar menu even though none of the coffee experts he had talked to had ever mentioned coffee lattes.

Schultz's 1983 trip to Milan produced a revelation—the Starbucks stores in Seattle completely missed the point. There was much more to the coffee business than just selling beans and getting people to appreciate grinding their own beans and brewing fine coffee in their homes. What Starbucks needed to do was serve fresh brewed coffee, espressos, and cappuccinos in its stores (in addition to beans and coffee equipment) and try to create an American version of the Italian coffee bar culture. Going to Starbucks should be an experience, a special treat, a place to meet friends and visit. Re-creating the authentic Italian coffee bar culture in the United States could be Starbucks' differentiating factor.

Schultz Becomes Frustrated

On Schultz's return from Italy, he shared his revelation and ideas for modifying the format of Starbucks' stores, but the owners strongly resisted, contending that Starbucks was a retailer, not a restaurant or coffee bar. They feared serving drinks would put them in the beverage business and diminish the integrity of Starbucks' mission as a purveyor of fine coffees. They pointed out that Starbucks had been profitable every year and there was no reason to rock the boat in a small, private company like Starbucks. It took Howard Schultz nearly a year to convince them to let him test an espresso bar when Starbucks opened its sixth store in April 1984. It was the first store designed to sell beverages and it was the first store located in downtown Seattle. Schultz asked for a 1,500-square-foot space to set up a full-scale Italian-style espresso bar, but he was allocated only 300 square feet in a corner of the new store. The store opened with no fanfare as a deliberate experiment to see what happened. By closing time on the first day, some 400 customers had been served, well above the 250-customer average of Starbucks' best performing stores. Within two months the store was serving 800 customers per day. The two baristas could not keep up with orders during the early morning hours, resulting in lines outside the door onto the sidewalk. Most of the business was at the espresso counter, while sales at the regular retail counter were only adequate.

Schultz was elated at the test results, expecting that the owners' doubts about entering the beverage side of the business would be dispelled and that he would gain approval to pursue the opportunity to take Starbucks to a new level. Every day he shared the sales figures and customer counts at the new downtown store. But the lead owner was not comfortable with the success of the new store, believing that it felt wrong and that espresso drinks were a distraction from the core business of marketing fine Arabica coffees at retail.[3] While he didn't deny that the experiment was succeeding, he would not agree to go forward with introducing beverages in other Starbucks stores.

Over the next several months, Schultz made up his mind to leave Starbucks and start his own company. His plan was to open espresso bars in high-traffic downtown locations, serve espresso drinks and coffee by the cup, and try to emulate the friendly, energetic atmosphere he had encountered in Italian espresso bars. The two owners, knowing how frustrated Schultz had become, supported his efforts to go out on his own and agreed to let him stay in his current job and office until definitive plans were in place. Schultz left Starbucks in late 1985.

Schultz's Il Giornale Venture

With the aid of a lawyer friend who helped companies raise venture capital and go public, Schultz began seeking out investors for the kind of company he had in mind. Ironically, one of the owners committed to investing $150,000 of Starbucks' money in Schultz's coffee bar enterprise and became Schultz's first investor. The other owner proposed that the new company be named Il Giornale Coffee Company (pronounced il-jor-nahl'-ee), a suggestion that Schultz accepted. In December 1985, Schultz and one of the Starbucks owners made a trip to Italy where they visited some 500 espresso bars in Milan and Verona, observing local habits, taking notes about décor and menus, snapping photographs, and videotaping baristas in action.

By the end of January 1986, Schultz had raised about $400,000 in seed capital, enough to rent an office, hire a couple of key employees, develop a store design, and open the first store. But it took until the end of 1986 to raise the remaining $1.25 million needed to launch at least eight espresso bars and prove that Schultz's strategy and business model were viable. Schultz made presentations to 242 potential investors, 217 of which said no. Many who heard Schultz's hour-long presentation saw coffee as a commodity business and thought that Schultz's espresso bar concept lacked any basis for sustainable competitive advantage (no patent on dark roast, no advantage in purchasing coffee beans, no way to bar the entry of imitative competitors). Some noted that coffee couldn't be turned into a growth business—consumption of coffee had been declining since the mid-1960s. Others were skeptical that people would pay $1.50 or more for a cup of coffee, and the company's unpronounceable name turned some off. Nonetheless, Schultz maintained an upbeat attitude and displayed passion and enthusiasm in making his pitch. He ended up raising $1.65 million from about 30 investors; most of the money came from nine people, five of whom became directors.

The first Il Giornale store opened in April 1986. It measured 700 square feet and was located near the entrance of Seattle's tallest building. The décor was Italian and there were Italian words on the menu. Italian opera music played in the background. The baristas wore white shirts and bow ties. All service was stand up—there were no chairs. National and international papers were hung on rods on the wall. By closing time on the first day, 300 customers had been served—mostly in the morning hours. But while the core idea worked well, it soon became apparent that several aspects of the format were not appropriate for Seattle. Some customers objected to the incessant opera music, others wanted a place to sit down; many people did not understand the Italian words on the menu. These "mistakes" were quickly fixed, but an effort was made not to compromise the style and elegance of the store. Within six months, the store was serving more than 1,000 customers a day. Regular customers had learned how to pronounce the company's name. Because most customers were in a hurry, it became apparent that speedy service was essential.

Six months after opening the first store, a second store was opened in another downtown building. In April 1987, a third store was opened in Vancouver, British Columbia, to test the transferability of the company's business concept outside Seattle. Schultz's goal was to open 50 stores in five years and he needed to dispel his investors' doubts about geographic expansion early on to achieve his growth objective. By mid-1987, sales at each of the three stores were running at a rate equal to $1.5 million annually.

Il Giornale Acquires Starbucks

In March 1987, the Starbucks owners decided to sell the whole Starbucks operation in Seattle—the stores, the roasting plant, and the Starbucks name. Schultz knew immediately that he had to buy Starbucks; his board of directors agreed. Schultz and his newly hired finance and accounting manager drew up a set of financial projections for the combined operations and a financing package that included a stock offering to Il Giornale's original investors and a line of credit with local banks. Within weeks, Schultz had raised the $3.8 million needed to buy Starbucks. The acquisition was completed in August 1987. The new name of the combined companies was Starbucks Corporation. Howard Schultz, at the age of 34, became Starbucks' president and CEO.

Starbucks as a Private Company: 1987–1992

The Monday morning after the deal closed, Howard Schultz returned to the Starbucks offices at the roasting plant, greeted all the familiar faces, and accepted their congratulations. Then, he called the staff together for a meeting on the roasting plant floor:

> All my life I have wanted to be part of a company and a group of people who share a common vision. . . . I'm here today because I love this company. I love what it represents. . . . I know you're concerned . . . I promise you I will not let you down. I promise you I will not leave anyone behind. . . . In five years, I want you to look back at this day and say "I was there when it started. I helped build this company into something great."[4]

Schultz told the group that his vision was for Starbucks to become a national company with values and guiding principles that employees could be proud of. He aspired for Starbucks to become the most respected brand name in coffee and for the company to be admired for its corporate responsibility. He indicated that he wanted to include people in the decision-making process and that he would be open and honest with them. For Schultz, building a company that valued and respected its people, that inspired them, and that shared the fruits of success with those who contributed to the company's long-term value was essential, not just an intriguing option. He made the establishment of mutual respect between employees and management a priority.

The business plan Schultz had presented investors called for the new nine-store company to open 125 stores in the next five years—15 the first year, 20 the second, 25 the third, 30 the fourth, and 35 the fifth. Revenues were projected to reach $60 million in 1992. But the company lacked experienced management. Schultz had never led a growth effort of such magnitude and was just learning what the job of CEO was all about, having been the president of a small company for barely two years. Dave Olsen, a Seattle coffee bar owner who Schultz had recruited to direct store operations at II Giornale, was still learning the ropes in managing a multistore operation. Ron Lawrence, the company's controller, had worked as a controller for several organizations. Other Starbucks employees had only the experience of managing or being a part of a six-store organization.

Schultz instituted a number of changes in the first several months. To symbolize the merging of the two companies and the two cultures, a new logo was created that melded the designs of the Starbucks logo and the Il Giornale logo. The Starbucks stores were equipped with espresso machines and remodeled to look more Italian than old-world nautical. Il Giornale green replaced the traditional Starbucks brown. The result was a new type of store—a cross between a retail coffee bean store and an espresso bar/café—that quickly evolved into Starbucks' signature.

By December 1987, the mood at Starbucks was distinctly upbeat, with most all employees buying into the changes that Schultz was making and trust beginning to build between management and employees. New stores were on the verge of opening in Vancouver and Chicago. One Starbucks store employee, Daryl Moore, who had started working at Starbucks in 1981 and who had voted against unionization in 1985, began to question the need for a union with his fellow employees. Over the next few weeks, Moore began a move to decertify the union. He carried a decertification letter around to Starbucks' stores, securing the signatures of employees who no longer wished to be represented by the union. He got a majority of store employees to sign the letter and presented it to the National Labor Relations Board. The union representing store employees was decertified. Later, in 1992, the union representing Starbucks' roasting plant and warehouse employees was also decertified.

Market Expansion Outside the Pacific Northwest

The first Chicago store opened in October 1987 and three more stores were opened over the next six months. Initially, customer counts at the stores were substantially below expectations because Chicagoans did not take to dark-roasted coffee as fast as Schultz had anticipated. While it was more expensive to supply fresh coffee to the Chicago stores out of the Seattle warehouse, the company solved the problem of freshness and quality assurance by putting freshly roasted beans in special FlavorLock bags that utilized vacuum packaging techniques with a one-way valve to allow carbon dioxide to escape without allowing air and moisture in. Moreover, rents and wage rates were higher in Chicago. The result was a squeeze on store profit margins. Gradually, customer counts improved, but Starbucks lost money on its Chicago stores until, in 1990, prices were raised to reflect higher rents and labor costs, more experienced store managers were hired, and a critical mass of customers caught on to the taste of Starbucks products.

Portland, Oregon, was the next market entered, and Portland coffee drinkers took to Starbucks products quickly. Store openings in Los Angeles and San Francisco soon followed. L.A. consumers embraced Starbucks quickly and the *Los Angeles Times* named Starbucks the best coffee in America before the first store opened.

Starbucks' store expansion targets proved easier to meet than Schultz had originally anticipated and he upped the numbers to keep challenging the organization. Starbucks opened 15 new stores in fiscal 1988, 20 in 1989, 30 in 1990, 32 in 1991, and 53 in 1992—producing a total of 161 stores, significantly above his original 1992 target of 125 stores.

From the outset, the strategy was to open only company-owned stores; franchising was avoided so as to keep the company in full control of the quality of its products and the character and location of its stores. But company ownership of all stores required Starbucks to raise new venture capital to cover the cost of new store expansion. In 1988, the company raised $3.9 million; in 1990, venture capitalists provided an additional $13.5 million; and in 1991, another round of venture capital financing generated $15 million. Starbucks was able to raise the needed funds despite posting losses of $330,000 in 1987, $764,000 in 1988, and $1.2 million in 1989. While the losses were troubling to Starbucks' board of directors and investors, Schultz's business plan had forecast losses during the early years of expansion. At a particularly tense board meeting where directors sharply questioned Schultz about the lack of profitability, Schultz said:

> Look, we're going to keep losing money until we can do three things. We have to attract a management team well beyond our expansion needs. We have to build a world-class roasting facility. And we need a computer information system sophisticated enough to keep track of sales in hundreds and hundreds of stores.[5]

Schultz argued for patience as the company invested in the infrastructure to support continued growth well into the 1990s. He contended that hiring experienced executives ahead of the growth curve, building facilities far beyond current needs, and installing support systems laid a strong foundation for rapid profitable growth later down the road. His arguments carried the day with the board and with investors, especially since revenues were growing approximately 80 percent annually and customer traffic at the stores was meeting or exceeding expectations.

Starbucks became profitable in 1990. After-tax profits had increased every year since 1990 except for fiscal year 2000 (because of $58.8 million in investment write-offs in four dot.com enterprises) and for fiscal year 2008 (when the sharp global economic downturn hit the company's bottom line very hard).

RAPID EXPANSION OF THE NETWORK OF STARBUCKS LOCATIONS

In 1992 and 1993, Starbucks began concentrating its store expansion efforts in the United States on locations with favorable demographic profiles that also could be serviced and supported by the company's operations infrastructure. For each targeted region, Starbucks selected a large city to serve as a hub; teams of professionals were located in hub cities to support the goal of opening 20 or more stores in the hub within two years. Once a number of stores were opened in a hub, then additional stores were opened in smaller surrounding "spoke" areas in the region. To oversee the expansion process, Starbucks had zone vice presidents who oversaw the store expansion process in a geographic region and who were also responsible for instilling the Starbucks culture in the newly opened stores. For a time, Starbucks went to extremes to blanket major cities with stores, even if some stores cannibalized a nearby store's business. While a new store might draw 30 percent of the business of an existing store two or so blocks away, management believed a "Starbucks everywhere" strategy cut down on delivery and management costs, shortened customer lines at individual stores, and increased foot traffic for all the stores in an area. In 2002, new stores generated an average of $1.2 million in first-year revenues, compared to $700,000 in 1995 and only $427,000 in 1990; the increases in new-store revenues were due partly to growing popularity of premium coffee drinks, partly to Starbucks' growing reputation, and partly to expanded product offerings. But by 2008 and 2009 the strategy of saturating big metropolitan areas with stores began cannibalizing sales of existing stores to such an extent that average annual sales per store in the United States dropped to less than $1,000,000 and pushed store operating margins down from double-digit levels to mid-single-digit levels. As a consequence, Starbucks' management cut the number of metropolitan locations, closing 900 underperforming Starbucks stores in 2008 and 2009, some 75 percent of which were within three miles of another Starbucks store.

Despite the mistake of oversaturating portions of some large metropolitan areas with stores, Starbucks was regarded as having the best real estate team in the coffee bar industry and a core competence in identifying good retailing sites for its new stores. The company's sophisticated methodology enabled it to identify not only the most attractive individual city blocks but also the exact store location that was best. It also worked hard at building good relationships with local real estate representatives in areas where it was opening multiple store locations.

Licensed Starbucks Stores In 1995, Starbucks began entering into licensing agreements for store locations in areas in the United States where it did not have the ability to locate company-owned outlets. Two early licensing agreements were with Marriott Host International to operate Starbucks retail stores in airport locations and with Aramark Food and Services to put Starbucks stores on university campuses and other locations operated by Aramark. Very quickly, Starbucks began to make increased use of licensing, both domestically and internationally. Starbucks preferred licensing to franchising because it permitted tighter controls over the operations of licensees, and in the case of many foreign locations licensing was much less risky.

Starbucks received a license fee and a royalty on sales at all licensed locations and supplied the coffee for resale at these locations. All licensed stores had to follow Starbucks' detailed operating procedures and all managers and employees who worked in these stores received the same training given to managers and employees in company-operated Starbucks stores.

International Expansion In markets outside the continental United States, Starbucks had a two-pronged store expansion strategy: either open company-owned-and-operated stores or else license a reputable and capable local company with retailing know-how in the target host country to develop and operate new Starbucks stores. In most countries, Starbucks utilized a local partner/licensee to help it locate suitable store sites, set up supplier relationships, recruit talented individuals for positions as store managers, and adapt to local market conditions. Starbucks looked for partners/licensees that had strong retail/restaurant experience, had values and a corporate culture compatible with Starbucks, were committed to good customer service, possessed talented management and strong financial resources, and had demonstrated brand-building skills. In those foreign countries where business risks were deemed relatively high, most if not all Starbucks stores were licensed rather than being company-owned and operated.

Exhibit 2 shows the speed with which Starbucks grew its network of company-operated and licensed retail stores.

STORE DESIGN AND AMBIENCE: KEY ELEMENTS OF THE "STARBUCKS EXPERIENCE"

Store Design

Starting in 1991, Starbucks created its own in-house team of architects and designers to ensure that each store would convey the right image and character. Stores had to be custom designed because the company did not buy real estate and build its own free-standing structures. Instead, each space was leased in an existing structure, making each store differ in

EXHIBIT 2 Company-Operated and Licensed Starbucks Stores

A. Number of Starbucks Store Locations Worldwide, Fiscal Years 1987–2015 and April 1, 2018

	Company-Operated Store Locations		Licensed Store Locations		
End of Fiscal Year*	United States	International	United States	International	Worldwide Total
1987	17	0	0	0	17
1990	84	0	0	0	84
1995	627	0	49	0	676
2000	2,446	530	173	352	3,501
2005	4,918	1,263	2,435	1,625	10,241
2010	6,707	2,182	4,424	3,545	16,858
2015	6,764	2,198	4,364	3,309	23,043
April 1, 2018	8,401	6,411	5,895	7,502	28,209

(Continued)

B. International Starbucks Store Locations, April 1, 2018

International Locations of Company-Operated Starbucks Stores		International Locations of Licensed Starbucks Stores			
		Americas		**Europe/Africa/Middle East**	
Canada	1,095	Canada	399	Turkey	417
United Kingdom	339	Mexico	666	United Kingdom	638
China	3,236	16 Others	592	United Arab Emirates	173
Japan	1,248			Spain	125
Thailand	332	**China, Asia-Pacific**		Saudi Arabia	147
Other	161	Taiwan	435	Kuwait	133
		South Korea	1,175	Russia	120
		Philippines	340	32 Others	912
		Malaysia	258		
		Indonesia	329		
		9 Others	642		
International Company-Operated Total	**6,411**			**International Licensed Total**	**7,502**

Source: Company records posted in the investor relations section at **www.starbucks.com** (accessed May 16, 2018).

size and shape. Most stores ranged in size from 1,000 to 1,500 square feet and were located in office buildings, downtown and suburban retail centers, airport terminals, university campus areas, and busy neighborhood shopping areas convenient for pedestrian foot traffic and/or drivers. A few were in suburban malls. Four store templates—each with its own color combinations, lighting scheme, and component materials—were introduced in 1996; all four were adaptable to different store sizes and settings.

But as the number of stores increased rapidly over the next 20-plus years, greater store diversity and layouts quickly became necessary. Some stores were equipped with special seating areas to help make Starbucks a desirable gathering place where customers could meet and chat or simply enjoy a peaceful interlude in their day. Flagship stores in high-traffic, high-visibility locations had fireplaces, leather chairs, newspapers, couches, and lots of ambience. Increasingly, the company began installing drive-through windows at locations where speed and convenience were important to customers and locating kiosks in high-traffic supermarkets, building lobbies, the halls of shopping malls, and other public places where passers-by could quickly and conveniently pick up a Starbucks beverage and/or something to eat.

A new global store design strategy was introduced in 2009. Core design characteristics included the celebration of local materials and craftsmanship, a focus on reused and recycled elements, the exposure of structural integrity and authentic roots, the absence of features that distracted from an emphasis on coffee, seating layouts that facilitated customer gatherings, an atmosphere that sought to engage all five customer senses (sight, smell, sound, hearing, and feel), and flexibility to meet the needs of many customer types.[6] Each new store was to be a reflection of the environment in which it operated and be environmentally friendly. In 2010, Starbucks began an effort to achieve LEED (Leadership in Energy and Environmental Design) certification for all new company-owned stores (a LEED-certified building had to incorporate green building design, construction, operations, and maintenance solutions).[7]

To better control average store opening costs, the company centralized buying, developed standard contracts and fixed fees for certain items, and consolidated work under those contractors who displayed good cost control practices. The retail operations group outlined exactly the minimum amount of equipment each core store needed, so that standard items could be ordered in volume from vendors at 20 to 30 percent discounts, then delivered just in time to the store site either from company warehouses or the vendor. Modular designs for display cases were developed. The layouts for new and remodeled stores were developed on a computer, with software that allowed the costs to be estimated as the design evolved. All this cut store opening and remodeling costs significantly and shortened the process to about 18 weeks.

Store Ambience

Starbucks management viewed each store as a billboard for the company and as a contributor to building the company's brand and image. The company went to great lengths to make sure the store fixtures, merchandise displays, colors, artwork, banners, music, and aromas all blended to create a consistent, inviting, stimulating environment that evoked the romance of coffee and signaled the company's passion for coffee. To try to keep the coffee aromas in the stores pure, smoking was banned, and employees were asked to refrain from wearing perfumes or colognes. Prepared foods were kept covered so customers would smell coffee only. Colorful banners and posters were used to keep the look of the Starbucks stores fresh and in keeping with seasons and holidays. All these practices reflected a conviction that every detail mattered in making Starbucks stores a welcoming and pleasant "third place" (apart from home and work) where people could meet friends and family, enjoy a quiet moment alone with a newspaper or book, or simply spend quality time relaxing—and most importantly, have a satisfying experience.

In 2002, Starbucks began providing Internet access capability and enhanced digital entertainment to patrons. The objective was to heighten the third place Starbucks experience, entice customers into perhaps buying a second latte or espresso while they caught up on e-mail, listened to digital music, put the finishing touches on a presentation, or surfed the Internet. Wireless Internet service and faster Internet speeds were added as fast as they became available.

STARBUCKS' STRATEGY TO EXPAND ITS PRODUCT OFFERINGS AND ENTER NEW MARKET SEGMENTS

Starting in the mid-1990s and continuing to the present, Howard Schultz began a long-term strategic campaign to expand Starbucks product offerings beyond its retail stores and to pursue sales of Starbucks products in a wider variety of distribution channels and market segments. The strategic objectives were to capitalize on Starbucks growing brand awareness and brand-name strength and create a broader foundation for sustained long-term growth in revenues and profits.

The first initiative involved the establishment of an in-house specialty sales group to begin marketing Starbucks coffee to restaurants, airlines, hotels, universities, hospitals, business offices, country clubs, and select retailers. Early users of Starbucks coffee included Horizon Airlines, a regional carrier based in Seattle, and United Airlines. The specialty sales group then soon won accounts at Hyatt, Hilton, Sheraton, Radisson, and Westin hotels, resulting in packets of Starbucks coffee being in each room with coffee-making equipment. Later, the specialty sales group began working with leading institutional foodservice distributors, including SYSCO Corporation and US Foodservice, to handle the distribution of Starbucks products to hotels, restaurants, office coffee distributors, educational and healthcare institutions, and other such enterprises. In fiscal year 2009, Starbucks generated revenues of $372.2 million from providing whole bean and ground coffees and assorted other Starbucks products to some 21,000 foodservice accounts.

The second initiative came in 1994 when PepsiCo and Starbucks entered into a joint venture arrangement to create new coffee-related products in bottles or cans for mass distribution through Pepsi channels. The joint venture's first new product, a lightly flavored carbonated coffee drink, was a failure. Then, at a meeting with Pepsi executives, Schultz suggested developing a bottled version of Frappuccino, a new cold coffee drink Starbucks began serving at its retail stores in the summer of 1995 that quickly became a big hot weather seller. Pepsi executives were enthusiastic. Sales of Frappuccino ready-to-drink beverages reached $125 million in 1997 and achieved a national supermarket penetration of 80 percent. Sales of ready-to-drink Frappuccino products soon began in Japan, Taiwan, South Korea, and China chiefly through agreements with leading local distributors. In 2010, sales of Frappuccino products worldwide reached $2 billion annually.[8]

In 1995, Starbucks partnered with Dreyer's Grand Ice Cream to supply coffee extracts for a new line of coffee ice cream made and distributed by Dreyer's under the Starbucks brand. Starbucks coffee-flavored ice cream became the number-one-selling super-premium brand in the coffee segment in mid-1996. In 2008, Starbucks discontinued its arrangement with Dreyer's and entered into an exclusive agreement with Unilever to manufacture, market, and distribute Starbucks-branded ice creams in the United States and Canada. Unilever was the global leader in ice cream with annual sales of about $6 billion; its ice cream brands included Ben & Jerry's, Breyers, and Good Humor. There were seven flavors of Starbucks ice cream and two flavors of novelty bars being marketed in 2010, but buyer demand eroded after several years and Starbucks-branded ice cream was discontinued in 2013. However, in 2017, new premium ice cream drinks (a scoop of ice cream drowned in expresso called an "affogato," several other affogato concoctions, and tall cold brew floats and malts) became top-10 menu items at the new Starbucks Roastery and Starbucks Reserve store locations in Seattle and were quickly rolled out to other Reserve locations.

In 1998, Starbucks licensed Kraft Foods to market and distribute Starbucks whole bean and ground coffees in grocery and mass merchandise channels across the United States. Kraft managed all distribution, marketing, advertising, and promotions and paid a royalty to Starbucks based on a percentage of net sales. Product freshness was guaranteed by Starbucks' FlavorLock packaging, and the price per pound paralleled the prices in Starbucks' retail stores. Flavor selections in supermarkets were more limited than the varieties at Starbucks stores. The licensing relationship with Kraft was later expanded to include the marketing and distribution of Starbucks coffees in Canada, the United Kingdom, and other European countries. Going into 2010, Starbucks coffees were available in some 33,500 grocery and warehouse clubs in the United States and 5,500 retail outlets outside the United States; Starbucks revenues from these sales were approximately $370 million in fiscal 2009.[9] During fiscal 2011, Starbucks discontinued its distribution arrangement with Kraft and instituted its own in-house organization to handle direct sales of packaged coffees to supermarkets and to warehouse club stores (chiefly Costco, Sam's Club, and BJ's Warehouse).

In 1999, Starbucks purchased Tazo Tea for $8.1 million. Tazo Tea, a tea manufacturer and distributor based in Portland, Oregon, was founded in 1994 and marketed its teas to restaurants, food stores, and tea houses. Starbucks proceeded to introduce hot and iced Tazo Tea drinks in its retail stores. As part of a long-term campaign to expand the distribution of its lineup of super-premium Tazo teas, Starbucks expanded its agreement with Kraft to market and distribute Tazo teas worldwide. In August 2008, Starbucks entered into a licensing agreement with a partnership formed by PepsiCo and Unilever (Lipton Tea was one of Unilever's leading brands) to manufacture, market, and distribute Starbucks' super-premium Tazo Tea ready-to-drink beverages (including iced teas, juiced teas, and herbal-infused teas) in the United States and Canada—in 2012, the Pepsi/Lipton Tea partnership was the leading North American distributor of ready-to-drink teas. In fiscal year 2011, when Starbucks broke off its packaged coffee distribution arrangement with Kraft, it also broke off its arrangement with Kraft for distribution of Tazo tea and began selling Tazo teas directly to supermarkets (except for Tazo Tea ready-to-drink beverages).

In 2001, Starbucks introduced the Starbucks Card, a reloadable card that allowed customers to pay for their purchases with a quick swipe of their card at the cash register and also to earn "stars" and redeem rewards. Since then, Starbucks Rewards™ had evolved into one of the best retail loyalty programs in existence, aided by the introduction of Starbucks Gift Cards, the Starbucks mobile app, rewards for in-store purchases and purchases of Starbucks products in grocery stores and other retail locations where Starbucks products were sold, and attractive member benefits for achieving "Green Star" status (0 to 299 stars in a 12-month period) and "Gold Star" status (300 or more stars in a 12-month period). Green level perks included two stars per $1 spent, free in-store refills on ice or brewed coffee, a birthday reward, eligibility for special Star Dash promotions, and invitations to special events. Gold level perks included all green level benefits plus the opportunity to take advantage of monthly Double-Star Day promotions, a free food and drink reward for each 125 points earned, and a personalized Gold Card (considered a status symbol among Rewards members). The app made it easy for members to see how many stars (points) they currently had, place orders and make payments right from their phone, and find the nearest Starbucks location. Members with a Starbucks Rewards™ Visa® Card also earned one star for every $4 purchased with the Starbucks Visa card. When members reloaded a registered Starbucks

Card using their Starbucks Rewards™ Visa® Card on the mobile app or Starbucks.com, they received one star for every dollar loaded in addition to the two stars for every dollar earned when using a registered Starbucks Card or the Starbucks mobile app for purchases in participating Starbucks stores. In 2017, there were over 20 million Starbuck Rewards™ members globally, and over 75 percent of Starbucks customers in North America either used a Starbucks Card or the Starbucks mobile app to pay for in-store purchases.

In 2003, Starbucks spent $70 million to acquire Seattle's Best Coffee, an operator of 540 Seattle's Best coffee shops, 86 Seattle's Best Coffee Express espresso bars, and marketer of some 30 varieties of Seattle's Best whole bean and ground coffees. The decision was made to operate Seattle's Best as a separate subsidiary. Starbucks quickly expanded its licensing arrangement with Kraft Foods to include marketing, distributing, and promoting the sales of Seattle's Best coffees and, by 2009, Seattle's Best coffees were available nationwide in supermarkets and at more than 15,000 foodservice locations (college campuses, restaurants, hotels, airlines, and cruise lines). A new Seattle's Best line of ready-to-drink iced lattes was introduced in April 2010, with manufacture, marketing, and distribution managed by PepsiCo as part of the long-standing Starbucks–PepsiCo joint venture for ready-to-drink Frappuccino products. In 2010, Starbucks introduced new distinctive red packaging and a red logo for Seattle's Best Coffee, boosted efforts to open more franchised Seattle's Best cafés, and expanded the availability of Seattle's Best coffees to 30,000 distribution points. When Starbucks' licensing agreement with Kraft to handle sales and distribution of Seattle's Best coffee products was terminated in 2011, responsibility for the sales and distribution of Seattle's Best products was transitioned to the same in-house sales force that handled direct sales and distribution of Starbucks-branded coffees and tea products to supermarkets and warehouse clubs.

In 2005, Starbucks Corporation acquired Ethos™ Water, a privately held bottled water company based in Santa Monica, California, whose mission was help children around the world get clean water by supporting water projects in such developing countries as Bangladesh, the Democratic Republic of Congo, Ethiopia, Honduras, India, and Kenya. One of the terms of the acquisition called for Starbucks to donate $1.25 million in 2005 and 2006 to support these projects. In the years since the acquisition, a key element of Starbucks' corporate social responsibility effort has been to donate $0.05US ($0.10CN in Canada) for every bottle of Ethos Water sold in Starbucks stores to the Ethos® Water Fund, part of the Starbucks Foundation, to fund ongoing efforts to provide clean water to children in developing countries and to support water, sanitation, and hygiene education programs in water-stressed countries.

In 2008, Starbucks introduced a new coffee blend called Pike Place™ Roast that would be brewed every day, all day, in every Starbucks store.[10] Before then, Starbucks rotated various coffee blends through its brewed lineup, sometimes switching them weekly, sometimes daily. While some customers liked the ever-changing variety, the feedback from a majority of customers indicated a preference for a consistent brew that customers could count on when they came into a Starbucks store. The Pike Place blend was brewed in small batches at 30-minute intervals so as to provide customers with a freshly-brewed coffee. In January 2012, after eight months of testing over 80 different recipe and roast iterations, Starbucks introduced three blends of lighter-bodied and milder-tasting Starbucks Blonde Roast® coffees to better appeal to an estimated 54 million coffee drinkers in the United States who said they liked flavorful, lighter coffees with a gentle finish. The Blonde Roast blends were available as a brewed option in Starbucks stores in the United States and in packaged form in Starbucks stores and supermarkets. Because the majority of coffee sales in supermarkets were in the light and medium roast categories, Starbucks management saw its new Blonde Roast coffees blends as being a $1 billion market opportunity in the United States alone. From time to time, Starbucks introduced new blends of its packaged whole bean and ground coffees—some of these were seasonal, but those that proved popular with buyers became standard offerings.

In Fall 2009, Starbucks introduced Starbucks VIA® Ready Brew, packets of roasted coffee in an instant form, in an effort to attract a bigger fraction of on-the-go and at-home coffee drinkers. VIA was made with a proprietary microground technology that produced an instant coffee with a rich, full-bodied taste that closely replicated the taste, quality, and flavor of traditional freshly brewed coffee. Encouraged by favorable customer response, Starbucks expanded the distribution of VIA to some 25,000 grocery, mass merchandise, and drugstore accounts, including Kroger, Safeway, Walmart, Target, Costco, and CVS. Instant coffee made up a significant fraction of coffee purchases in the United Kingdom (80 percent), Japan (53 percent), Russia (85 percent), and other countries where Starbucks stores were located; globally, the instant and single-serve coffee category was a $23 billion market. By the end of fiscal year 2011, VIA products were available at 70,000 locations and generating annual sales of $250 million.[11]

In fall 2011, Starbucks began selling Starbucks-branded coffee K-Cup® Portion Packs for the Keurig® Single-Cup Brewing system in its retail stores; the Keurig Brewer was produced and sold by Green Mountain Coffee Roasters. Starbucks entered into a strategic partnership with Green Mountain to manufacture the Starbucks-branded portion packs and also to be responsible for marketing, distributing, and selling them to major supermarket chains, drugstore chains, mass merchandisers and wholesale clubs, department stores, and specialty retailers throughout the United States and Canada. The partnership made good economic sense for both companies. Green Mountain could manufacture the single-cup portion packs in the same plants where it was producing its own brands of single-cup packs and then use its own internal resources and capabilities to market, distribute, and sell Starbucks-branded single-cup packs alongside its own brands of single-cup packs. It was far cheaper for Starbucks to pay Green Mountain to handle these functions than to build its own manufacturing plants and put its own in-house resources in place to market, distribute, and sell Starbucks single-cup coffee packs. Just two months after launch, shipments of Starbucks-branded single-cup portion packs had exceeded 100 million units and the packs were available in about 70 percent of the targeted retailers; company officials estimated that Starbucks had achieved an 11 percent dollar share of the market for single-cup coffee packs in the United States.[12]

In March 2012, Starbucks announced that it would begin selling its first at-home premium single cup espresso and brewed coffee machine, the Verismo™ system by Starbucks, at select Starbucks store locations, online, and in upscale specialty stores. The Verismo brewer was a high-pressure system with the capability to brew both coffee and Starbucks-quality espresso beverages, from lattes to americanos, consistently and conveniently one cup at a time; sales of the Verismo single-cup machine put Starbucks into head-to-head competition with Nestlé's Nespresso machine and, to a lesser extent, Green Mountain's popular lineup of low-pressure Keurig brewers. At the time, the global market for premium at-home espresso/coffee machines was estimated at $8 billion.[13] The Verismo introduction was the last phase of Starbucks' strategic initiative to offer coffee products covering all aspects of the single-cup coffee segment—instant coffees (with its VIA offerings), single portion coffee packs for single-cup brewers, and single-cup brewing machines.

In response to customer requests for more wholesome food and beverage options and also to bring in business from non-coffee drinkers, in 2008 Starbucks altered its menu offerings in stores to include fruit cups, yogurt parfaits, skinny lattes, banana walnut bread, a 300-calorie farmer's market salad with all-natural dressing, and a line of 250-calorie "better-for-you" smoothies.[14] From 2009 to 2011, the company continued to experiment with healthier, lower-calorie selections and by May 2012 retail store menus included a bigger assortment of hot and cold coffee and tea beverages, pastries and bakery selections, prepared breakfast and lunch sandwiches and wraps, salads, parfaits, smoothies, juices, and bottled water—at most stores in North America, food items could be warmed. A bit later, beer, wine, and other complementary food offerings were added to the menus at some stores to help them become an attractive and relaxing after-work destination. From 2013 to 2017, it became standard practice for Starbucks to continually tweak its menu offerings, switching out whimsical and limited-edition offerings and adding or dropping certain beverages, flavorings, breakfast items, sandwiches, pastries, and snacks—both to broaden buyer appeal and respond to ongoing shifts in buyer preferences. Menu offerings at Starbucks stores were typically adapted to local cultures; for instance, the menu offerings at stores in North America included a selection of muffins, but stores in France had no muffins and instead featured locally made pastries.

Starbucks purchased cold-pressed juice maker Evolution Fresh for $30 million in 2011 to use Starbucks sales and marketing resources to grow the sales of Evolution Fresh and capture a bigger share of the $3.4 billion super-premium juice segment and begin a long-term campaign to pursue growth opportunities in the $50 billion health and wellness sector of the U.S. economy. A $70 million juice-making facility in California was opened in 2013 to make Evolution Fresh products. Starbucks also opened four Evolution Fresh juice bars after the acquisition, but in 2017 decided to ditch the standalone juice bar concept, opting to sell Evolution Fresh beverages in Starbucks stores and supermarkets. Evolution Fresh competed with PepsiCo's category leader Naked juice brand, as well as scores of other large and small bottled juice brands. As of 2017, Starbucks had secured 20,000 points of distribution for Evolution Fresh products and the brand was said to be "thriving."

In 2012, Starbuck paid $620 million to acquire Atlanta-based specialty tea retailer, Teavana, which sold more than 100 varieties of premium loose-leaf teas and tea-related merchandise through 300 company-owned stores (usually located in upscale shopping malls) and on its website; Teavana teas were used mostly for home consumption. Howard Schultz planned for Starbucks to capitalize on Teavana's world-class tea authority, its passion for tea, and its global sourcing and merchandising capabilities to (a) expand Teavana's domestic and global footprint, (b) bring an elevated tea experience to the patrons of Starbucks domestic and international locations, and (c) increase Starbucks penetration of the $40 billion world market for tea, especially in the world's high-consumption tea markets where Starbucks had stores. By 2016 and 2017 sales at Teavana stores had eroded to the point where the stores were unprofitable, prompting Starbucks to begin the process of closing all 379 Teavana stores (the majority by Spring 2018). However, the sales of Teavana products and beverages in Starbucks stores were popular and contributed to store profitability, accounting for sales of more than $1 billion annually and growing fast enough to double over the next five years. In late 2017, Starbucks sold its Tazo Tea business to Unilever for $384 million, opting to focus its sales of tea products on the Teavana brand.

Also in 2012, Starbucks bought Bay Bread Group's La Boulange sandwich and coffee shops for $100 million. When Starbucks acquired the San Francisco chain, plans called not only for bringing La Boulange products into its stores to bolster its lineup of pastries and sandwiches but also to open new La Boulange cafes and expand the chain's geographic footprint. Three years later, however, Starbucks concluded that sales at the La Boulange cafes were growing too slowly to support its growth and profitability targets; it closed the 23 existing La Boulange cafes but retained the manufacturing facilities to stock Starbucks stores with La Boulange bakery products. In 2018, the La Boulange brand name was typically not very visible in Starbucks stores but La Boulange-made morning pastries and breakfast sandwiches were still popular sellers during the morning hours when customer traffic at Starbucks stores was high.

Starbucks' overall sales mix in its company-owned retail stores in fiscal year 2017 was 73 percent beverages, 20 percent food, 3 percent packaged and single-serve coffees and teas, and 4 percent ready-to-drink beverages, coffee-making equipment, and other merchandise.[15] However, the product mix in each Starbucks store varied, depending on the size and location of each outlet. Larger stores carried a greater variety of whole coffee beans, gourmet food items, teas, coffee mugs, coffee grinders, coffee-making equipment, filters, storage containers, and other accessories. Smaller stores and kiosks typically sold a full line of coffee and tea beverages, a limited selection of whole bean and ground coffees and Tevana teas, and a few coffee-drinking accessories.

Starbucks' Consumer Products Group

In 2010, Starbucks formed a new Consumer Products Group (CPG) to be responsible for sales of Starbucks products sold in all channels other than Starbucks company-operated and licensed retail stores and to manage the company's partnerships and joint ventures with PepsiCo, Unilever, Green Mountain Coffee Roasters, and others. A few years later, CPG was renamed and slightly reorganized into what was called the Channel Development segment. In 2018, management of the Channel Development segment was responsible for sales and distribution of roasted whole bean and ground coffees, Starbucks-branded single-serve products, a variety of ready-to-drink beverages (such as Frappuccino®, Starbucks Doubleshot®, and Starbucks Refreshers® beverages), Evolution juices, and and other branded products sold worldwide through grocery stores, warehouse clubs, specialty retailers, convenience stores, and U.S. foodservice accounts. This segment accounted for sales of $2.0 billion and operating income of $893.4 million in fiscal year 2017, up from revenues of $707.4 million and operating income of $261.4 million in fiscal year 2010. Starbucks executives considered that the sales opportunities for Starbucks products in distribution channels outside Starbucks retail stores were quite attractive from the standpoint of both long-term growth and profitability.

Advertising

Starbucks spent sparingly on advertising, preferring instead to build the brand cup by cup with customers and depend on word of mouth and the appeal of its storefronts. However, Starbucks opted to significantly step up its advertising to combat the strategic initiatives of McDonald's and several other fast-food chains in 2008 and 2009 to begin offering premium coffees and coffee drinks at prices below those charged by Starbucks. In 2009, McDonald's reportedly spent more than $100 million on television, print, radio, billboard, and online ads promoting its new line of McCafé coffee drinks. Starbucks countered with the biggest advertising campaign the company had ever undertaken, spending a total of $176.2 million in fiscal 2010 versus $126.3 million the prior year.[16] The company's advertising expenses totaled $282.6 million in fiscal year 2017, $248.6 million in fiscal 2016, and $227.9 million in fiscal 2015.

HOWARD SCHULTZ'S EFFORTS TO MAKE STARBUCKS A GREAT PLACE TO WORK, 1988–PRESENT

Howard Schultz deeply believed that Starbucks' success was heavily dependent on customers having a very positive experience in its stores. This meant having store employees who were knowledgeable about the company's products, who paid attention to detail in preparing the company's espresso drinks, who eagerly communicated the company's passion for coffee, and who possessed the skills and personality to deliver consistent, pleasing customer service. Many of the baristas were in their 20s and worked part-time, going to college on the side or pursuing other career activities. Schultz viewed the company's challenge as one of attracting, motivating, and rewarding store employees in a manner that would make Starbucks a company that people would want to work for and that would generate enthusiastic commitment and higher levels of customer service. Moreover, Schultz wanted to send all Starbucks employees a message that would cement the trust that had been building between management and the company's workforce.

Instituting Health Care Coverage for All Employees

One of the requests that employees had made to the prior owners of Starbucks in the 1980s was to extend health care benefits to part-time workers. Their request had been turned down, but Schultz believed that expanding health care coverage to include part-timers was something the company needed to do. He knew from having grown up in a family that struggled to make ends meet how difficult it was to cope with rising medical costs. In 1988, Schultz went to the board of directors with his plan to expand the company's health care coverage to include part-timers who worked at least 20 hours per week. He saw the proposal not as a generous gesture but as a core strategy to win employee loyalty and commitment to the company's mission. Board members resisted because the company was then unprofitable and the added costs of the extended coverage would only worsen the company's bottom line. But Schultz argued passionately that it was the right thing to do and would not be as expensive as it seemed. He observed that if the new benefit reduced turnover, which he believed was likely, then it would reduce the costs of hiring and training—which equaled about $3,000 per new hire. He further pointed out that it cost $1,500 a year to provide an employee with full benefits. Part-timers, he argued, were vital to Starbucks, constituting two-thirds of the company's workforce. Many were baristas who knew the favorite drinks of regular customers; if the barista left, that connection with the customer was broken. Moreover, many part-time employees were called upon to open the stores early, sometimes at 5:30 or 6 a.m.; others had to work until closing, usually 9 p.m. or later. Providing these employees with health care benefits, he argued, would signal that the company honored their value and contribution.

The board approved Schultz's plan and part-timers working 20 or more hours were offered the same health coverage as full-time employees starting in late 1988. Starbucks paid 75 percent of an employee's health care premium; the employee paid 25 percent. Over the years, Starbucks extended its health coverage to include preventive care, prescription drugs, dental care, eye care, mental health, and chemical dependency. Coverage was also offered for unmarried partners in a committed relationship. Since most Starbucks employees were young and comparatively healthy, the company had been able to provide broader coverage while keeping monthly payments relatively low.

A Stock Option Plan for Employees

By 1991, the company's profitability had improved to the point where Schultz could pursue a stock option plan for all employees, a program he believed would have a positive, long-term effect on the success of Starbucks.[17] Schultz wanted to turn every Starbucks employee into a partner, give them a chance to share in the success of the company, and make clear the connection between their contributions and the company's market value. Even though Starbucks was still a private company, the plan that emerged called for granting stock options to every full-time and part-time employee in proportion to their base pay. In May 1991, the plan, dubbed Bean Stock, was presented to the board. Though board members were concerned that increasing the number of shares might unduly dilute the value of the shares of investors who had put up hard cash, the plan received unanimous approval. The first grant was made in October 1991, just after the end of the company's fiscal year in September; each partner was granted stock options worth 12 percent of base pay. When the Bean Stock program was initiated, Starbucks dropped the term employee and began referring to all of its people as "partners" because every member of the Starbucks workforce became eligible for stock option awards after six months of employment and 500 paid work hours.

Starbucks went public in June 1992, selling its initial offering at a price of $17 per share. Starting in October 1992 and continuing through October 2004, Starbucks granted each eligible employee a stock option award with a value equal to 14 percent of base pay. Beginning in 2005, the plan was modified to tie the size of each employee's stock option awards to three factors: (1) Starbucks' success and profitability for the fiscal year, (2) the size of an employee's base wages, and (3) the price at which the stock option could be exercised. Since becoming a public company, Starbucks stock had split 2-for-1 on six occasions. Performance-based stock awards to employees totaled about five million shares in fiscal year 2017; these shares had an average value of $54.30 on the date of the grant and vested in two equal annual installments beginning two years from the grant date.

Starbucks' Stock Purchase Plan for Employees

In 1995, Starbucks implemented an employee stock purchase plan that gave partners who had been employed for at least 90 days an opportunity to purchase company stock through regular payroll deductions. Partners who enrolled could devote anywhere from 1 to 10 percent of their base earnings (up to an annual maximum of $25,000) to purchasing shares of Starbucks stock. After the end of each calendar quarter, each participant's contributions were used to buy Starbucks stock at a discount of 5 percent of the closing price on the last business day of each calendar quarter (until March 2009, the discount was 15 percent). Roughly 30 percent of Starbucks partners participated in the stock purchase plan during the 2000 to 2011 period. Participation has eroded in the past two fiscal years due to Starbucks flat stock price performance since October 2015—the company's global workforce of about 277,000 employees purchased about 500,000 shares in fiscal year 2017.

Since inception of the plan, some 24.8 million shares had been purchased by partners.

The Workplace Environment

Starbucks management believed its competitive pay scales and comprehensive benefits for both full-time and part-time partners (employees) allowed it to attract motivated people with above-average skills and good work habits. An employee's base pay was determined by the pay scales prevailing in the geographic region where an employee worked and by the person's job, skills, experience, and job performance. About 90 percent of Starbucks' partners were full-time or part-time baristas, paid on an hourly basis. In 2018, after six months of employment, baristas at company-owned stores in the United States could expect to earn $10 to $11 per hour. Hourly-paid shift supervisors earned about $12 to $13 an hour; store managers earned about $50,000 and salaries for district managers were in the $75,000 to $85,000 range.[18]

Starbucks was named to *Fortune*'s list of the "100 Best Companies to Work For" 14 times during the 1988 to 2018 period. Surveys of Starbucks partners conducted by *Fortune* magazine in the course of selecting companies for inclusion on its annual list indicated that full-time baristas liked working at Starbucks because of the camaraderie, while part-timers were particularly pleased with the health insurance benefits.[19]

Schultz's approach to offering employees good compensation and a comprehensive benefits package was driven by his belief that sharing the company's success with the people who made it happen helped everyone think and act like an owner, build positive long-term relationships with customers, and do things in an efficient way. Schultz's rationale, based on his father's experience of going from one low-wage, no-benefits job to another, was that if you treat your employees well, that is how they will treat customers.

Exhibit 3 summarizes Starbucks' fringe benefit package.

EXHIBIT 3 Starbucks' Fringe Benefit Program, 2018

- Medical, dental, and vision coverage.
- Sick pay, up to 40 hours per year.
- Paid vacations (up to 120 hours annually for hourly workers with five or more years of service at retail stores and up to 200 hours annually for salaried and non-retail hourly employees with 10 or more years of service).
- Seven paid holidays.
- One paid personal day every six months for salaried and non-retail hourly partners only.
- A 30 percent discount on purchases of beverages, food, and merchandise at Starbucks stores.
- Mental health and chemical dependency coverage.
- 401(k) retirement savings plan—partners age 18 or older with 90 days of service were eligible to contribute from 1 percent to 75 percent of their pay each pay period (up to the annual IRS dollar limit—$18,500 for calendar year 2018). Partners age 50 and older had a higher IRS annual limit ($24,500 for calendar year 2018). Starbucks matched 100 percent of the first 5 percent of eligible pay contributed each pay period. Starbucks matching contributions to the 401(k) plans worldwide totaled $101.4 million in fiscal 2017 and $86.2 million in fiscal 2016.
- Short- and long-term disability.
- Stock purchase plan—eligible employees could buy shares at a 5 percent discount through regular payroll deductions of between 1 and 10 percent of base pay. In fiscal 2017, about 500,000 shares were purchased under this plan.
- Life insurance coverage equal to annual base pay for salaried and non-retail employees; coverage equal to $5,000 for store employees. Supplemental coverage could be purchased in flat dollar amounts of $10,000, $25,000, and $45,000.
- Short-term disability coverage (partial replacement of lost wages/income for 26 weeks, after a short waiting period); hourly employees can purchase long-term disability coverage.
- Company-paid long-term disability coverage for salaried and nonretail employees.
- Accidental death and dismemberment insurance.
- Adoption assistance—reimbursement of up to $10,000 to help pay for qualified expenses related to the adoption of an eligible child.
- Financial assistance program for employees that experience a financial crisis.
- Stock option plan (Bean stock)—shares were granted to eligible partners, subject to the company's achievement of specified performance targets and the employee's continued employment through the vesting period. Vesting occurred in two equal annual installments beginning two years from the grant date. The company's board of directors determined how many shares were to be granted each year and also established the specified performance targets. About 5.1 million shares were granted in fiscal year 2017.
- Pre-tax payroll deductions for work-related commuter expenses.
- Free coffee and tea products each week.
- An in-store discount of 30 percent on purchases of beverages, food, and merchandise.
- Full tuition reimbursement every semester through Arizona State University's top ranked online degree programs.
- Gift-matching benefits—Starbucks matched up to $1,500 per fiscal year for individual contributions of money or volunteer time to eligible non-profit organizations.

Source: Information in the Careers section at **www.starbucks.com** (accessed May 31, 2018).

Employee Training and Recognition

To accommodate its strategy of rapid store expansion, Starbucks put in systems to recruit, hire, and train baristas and store managers. Starbucks' vice president for human resources used some simple guidelines in screening candidates for new positions, "We want passionate people who love coffee . . . . We're looking for a diverse workforce, which reflects our community. We want people who enjoy what they're doing and for whom work is an extension of themselves."[20]

Every partner/barista hired for a retail job in a Starbucks store received at least 24 hours training in their first two to four weeks. Training topics included coffee history, drink preparation, coffee knowledge, customer service, and retail skills, plus a four-hour workshop on "Brewing the Perfect Cup." Baristas spent considerable time learning about beverage preparation—grinding the beans, steaming milk, learning to pull perfect (18- to 23-second) shots of espresso, memorizing the recipes of all the different drinks, practicing making the different drinks, and learning how to customize drinks to customer specifications. There were sessions on cash register operations, how to clean the milk wand on the espresso machine, explaining the Italian drink names to unknowing customers, making eye contact with customers and interacting with them, and taking personal responsibility for the cleanliness of the store. And there were rules to be memorized: milk must be steamed to at least 150 degrees Fahrenheit but never more than 170 degrees; every espresso shot not pulled within 23 seconds must be tossed; never let coffee sit in the pot more than 20 minutes; always compensate dissatisfied customers with a Starbucks coupon that entitles them to a free drink.

There were also training programs for shift supervisors, assistant store managers, store managers, and district managers that went much deeper, covering not only coffee knowledge and information imparted to baristas but also the details of store operations, practices and procedures as set forth in the company's operating manual, information systems, and the basics of managing people. In addition, there were special career development programs, such as a coffee masters program for store employees and more advanced leadership skills training for shift supervisors and store management personnel. When Starbucks opened stores in a new market, it sent a Star team of experienced managers and baristas to the area to lead the store opening effort and to conduct one-on-one training following the basic orientation and training sessions.

To recognize and reward partner contributions, Starbucks had created a partner recognition program consisting of 18 different awards and programs.[21] Examples included Partner of the Quarter Awards (for one partner per store per quarter) for significant contributions to their store and demonstrating behaviors consistent with the company's mission and values; Spirit of Starbucks awards for making exceptional contributions to partners, customers, and community while embracing the company's mission and values; a Manager of the Quarter for store manager leadership; Green Apron Awards where partners could recognize fellow partners for how they bring to life the company's mission, values, and customer commitment; and Bravo and Team Bravo! awards for above and beyond the call of duty performance and achieving exceptional results.

STARBUCKS' MISSION, BUSINESS PRINCIPLES, AND VALUES

During the early building years, Howard Schultz and other Starbucks senior executives worked to instill some values and guiding principles into the Starbucks culture. The cornerstone value in their effort "to build a company with soul" was that the company would never stop pursuing the perfect cup of coffee by buying the best beans and roasting them to perfection. Schultz was adamant about controlling the quality of Starbucks products and building a culture common to all stores. He was rigidly opposed to selling artificially flavored coffee beans—"we will not pollute our high-quality beans with chemicals"; if a customer wanted hazelnut-flavored coffee, Starbucks would provide it by adding hazelnut syrup to the drink, rather than by adding hazelnut flavoring to the beans during roasting. Running flavored beans through the grinders left chemical residues behind that altered the flavor of beans ground afterward.

Starbucks' management was also emphatic about the importance of employees paying attention to what pleased customers. Employees were trained to go out of their way, and to take heroic measures if necessary, to make sure customers were fully satisfied. The theme was "just say yes" to customer requests. Further, employees were encouraged to speak their minds without fear of retribution from upper management—senior executives wanted employees to be vocal about what Starbucks was doing right, what it was doing wrong, and what changes were needed. The intent was for employees to be involved in and contribute to the process of making Starbucks a better company.

Starbucks' Mission Statement

In early 1990, the senior executive team at Starbucks went to an offsite retreat to debate the company's values and beliefs and draft a mission statement. Schultz wanted the mission statement to convey a strong sense of organizational purpose and to articulate the company's fundamental beliefs and guiding principles. The draft was submitted to all employees for review and several changes were made based on employee comments. The resulting mission statement and guiding principles are shown in Exhibit 4. In 2008, Starbucks partners from all across the company met for several months to refresh the mission statement and rephrase the underlying guiding principles; the revised mission statement and guiding principles are also shown in Exhibit 6.

In 2018, Starbucks stated values were:

- Creating a culture of warmth and belonging, where everyone is welcome.
- Acting with courage, challenging the status quo and finding new ways to grow our company and each other.
- Being present, connecting with transparency, dignity, and respect.
- Delivering our best in all we do, holding ourselves accountable for results.
- We are performance driven, through the lens of humanity.[22]

In addition to being expected to live by the company's values, all Starbucks personnel were expected to conform to the highest standards of ethical conduct and to take all legal and ethical responsibilities seriously.

STARBUCKS' COFFEE PURCHASING STRATEGY

Coffee beans were grown in 70 tropical countries and were the second most traded commodity in the world after petroleum. Most of the world's coffee was grown by some 25 million small farmers, most of whom lived on the edge of poverty. Starbucks personnel traveled regularly to coffee-producing countries, building relationships with growers and exporters, checking on agricultural conditions and crop yields, and searching out varieties and sources that would meet Starbucks' exacting standards of quality and flavor. The coffee-purchasing group, working with Starbucks personnel in roasting operations, tested new varieties and blends of green coffee beans from different sources. The company's supplies of green coffee beans were chiefly grown on about one million small family farms (less than 30 acres) located in the coffee-growing communities of countries across the world. Sourcing from multiple geographic areas not only allowed Starbucks to offer a greater range of coffee varieties to customers but also spread its risks regarding weather, price volatility, and changing economic and political conditions in coffee-growing countries.

Starbucks' coffee sourcing strategy had three key elements:

- Make sure that the prices Starbucks paid for green (unroasted) coffee beans was high enough to ensure that small farmers were able to cover their production costs and provide for their families. The company was firmly committed to a goal of "100 percent ethically-sourced coffees"—in 2016 management believed it had reached a milestone of 99 percent ethically sourced coffee.[23] Because the company also purchased tea and cocoa for its stores, it was similarly committed to 100 percent ethically sourced tea and cocoa.
- Utilize purchasing arrangements that limited Starbucks exposure to sudden price jumps due to weather, economic and political conditions in the growing countries, new agreements establishing export quotas, and periodic efforts to bolster prices by restricting coffee supplies.
- Work directly with small coffee growers, local coffee-growing cooperatives, and other types of coffee suppliers to promote coffee cultivation methods that were environmentally sustainable. Starbucks objective was to "make coffee the world's first sustainable agricultural product."[24]

Pricing and Purchasing Arrangements

Commodity-grade coffee was traded in a highly competitive market as an undifferentiated product. However, high-altitude Arabica coffees of the quality

EXHIBIT 4 Starbucks' Mission Statement and Business Principles

Mission Statement, 1990–October 2008

Establish Starbucks as the premier purveyor of the finest coffee in the world while maintaining our uncompromising principles as we grow.

The following six guiding principles will help us measure the appropriateness of our decisions:

- Provide a great work environment and treat each other with respect and dignity.
- Embrace diversity as an essential component in the way we do business.
- Apply the highest standards of excellence to the purchasing, roasting, and fresh delivery of our coffee.
- Develop enthusiastically satisfied customers all of the time.
- Contribute positively to our communities and our environment.
- Recognize that profitability is essential to our future success.

Mission Statement, October 2008–Present

Our Mission: To inspire and nurture the human spirit—one person, one cup, and one neighborhood at a time.

Here are the principles of how we live that every day:

Our Coffee

It has always been, and will always be, about quality. We're passionate about ethically sourcing the finest coffee beans, roasting them with great care, and improving the lives of people who grow them. We care deeply about all of this; our work is never done.

Our Partners

We're called partners, because it's not just a job, it's our passion. Together, we embrace diversity to create a place where each of us can be ourselves. We always treat each other with respect and dignity. And we hold each other to that standard.

Our Customers

When we are fully engaged, we connect with, laugh with, and uplift the lives of our customers—even if just for a few moments. Sure, it starts with the promise of a perfectly made beverage, but our work goes far beyond that. It's really about human connection.

Our Stores

When our customers feel this sense of belonging, our stores become a haven, a break from the worries outside, a place where you can meet with friends. It's about enjoyment at the speed of life—sometimes slow and savored, sometimes faster. Always full of humanity.

Our Neighborhood

Every store is part of a community, and we take our responsibility to be good neighbors seriously. We want to be invited in wherever we do business. We can be a force for positive action—bringing together our partners, customers, and the community to contribute every day. Now we see that our responsibility—and our potential for good—is even larger. The world is looking to Starbucks to set the new standard, yet again. We will lead.

Our Shareholders

We know that as we deliver in each of these areas, we enjoy the kind of success that rewards our shareholders. We are fully accountable to get each of these elements right so that Starbucks—and everyone it touches—can endure and thrive.

Source: Company documents and postings at **www.starbucks.com** (accessed May 15, 2012).

purchased by Starbucks were bought on a negotiated basis at a substantial premium above commodity coffee. The prices of the top-quality coffees sourced by Starbucks depended on supply and demand conditions at the time of the purchase and were subject to considerable volatility due to weather, economic and political conditions in the growing countries, new agreements establishing export quotas, and periodic efforts to bolster prices by restricting coffee supplies.

Starbucks bought coffee using fixed-price and price-to-be-fixed purchase commitments, depending on market conditions, to secure an adequate supply of quality green coffee. Price-to-be-fixed contracts were purchase commitments whereby the quality, quantity, delivery period, and other negotiated terms were agreed upon, but the date at which the base price component of commodity grade coffee was to be fixed was as yet unspecified. For these types of contracts, either Starbucks or the seller had the option to select a date on which to "fix" the base price of commodity grade coffee prior to the delivery date. As of October 1, 2017, Starbucks had a total of $1.2 billion in purchase commitments, comprised of $860 million under fixed-price contracts and an estimated $336 million under price-to-be-fixed contracts. All of the price-to-be-fixed contracts gave Starbucks the right to fix the base price component of commodity-grade coffee. Management believed that its purchase agreements as of October 2017, together with its existing inventory, would provide an adequate supply of green coffee through fiscal year 2018.[25]

Food products, such as pastries, breakfast sandwiches and lunch items, were purchased from national, regional and local sources, as were needed paper and plastic products, such as cups and cutlery. Management believed, based on relationships established with these suppliers and manufacturers, that the risk of non-delivery of sufficient amounts of these items to its various store locations was remote.

Starbucks' Ethical Sourcing Practices for Coffee Beans

Starbucks was committed to buying green coffee beans that were grown in accordance with environmentally sustainable agricultural practices and guaranteed that small coffee growers received prices for their green coffee beans sufficiently high enough to allow them to pay fair wages to their workers, earn enough to reinvest in their farms and communities, develop the business skills needed to compete in the global market for coffee, and afford basic health care, education, and home improvements. To promote achievement of these outcomes, Starbucks operated eight farmer support centers staffed with agronomists and sustainability experts who worked with coffee farming communities to promote best practices in coffee production, implement advanced soil-management techniques, improve both coffee quality and yields, and address climate and other impacts.

Since 1998, Starbucks had partnered with Conservation International's Center for Environmental Leadership to develop specific guidelines (called Coffee and Farmer Equity [C.A.F.E.] Practices) covering four areas: product quality, the price received by farmers/growers, safe and humane working conditions (including compliance with minimum wage requirements and child labor provisions), and environmentally responsible cultivation practices.[26] Top management at Starbucks set a goal that by 2015 all of the green coffee beans purchased from growers would be C.A.F.E. Practice certified, Fair Trade certified, organically certified, or certified by some other equally acceptable third party. By 2011, 86 percent of Starbucks purchases of green coffee beans were C.A.F.E. Practices–verified sources and about 8 percent were from Fair Trade–certified sources, making Starbucks among the world's largest purchasers and marketers of Fair Trade–certified coffee beans.

In September 2015, Starbucks launched the One Tree for Every Bag Commitment, an effort to plant 20 million coffee tree seedlings to replace trees declining in productivity due to age and disease such as coffee leaf rust. The goal was exceeded in just over a year. To build on that success, Starbucks committed to providing another 80 million coffee tree seedlings to farmers by 2025, particularly in coffee-growing communities being impacted by climate change.

Small Farmer Support Programs Because many of small family farms that grew coffees purchased by Starbucks often lacked the money to make farming improvements and/or cover all expenses until they sold their crops, Starbucks provided funding for loans to small coffee growers. In 2010, $14.6 million was loaned to nearly 56,000 farmers who grew green coffee beans for Starbucks in 10 countries; in 2011, $14.7 million was loaned to over 45,000 farmers who grew green coffee beans for Starbucks in seven countries. Later, the company established the Starbucks

Global Farmer Fund, a $50 million commitment to provide loans to coffee farmers to support agronomy, restoration and infrastructure improvements. Moreover, the Starbucks Foundation began partnering with organizations with local expertise to award grants to support smallholder-farming families in coffee-growing and tea-growing communities, reaching approximately 47,000 direct and indirect beneficiaries. By 2020 the Foundation planned to reach 250,000 people.

COFFEE ROASTING OPERATIONS

Starbucks considered the roasting of its coffee beans to be something of an art form, entailing trial-and-error testing of different combinations of time and temperature to get the most out of each type of bean and blend. Recipes were put together by the coffee department, once all the components had been tested. Computerized roasters guaranteed consistency. Highly trained and experienced roasting personnel monitored the process, using both smell and hearing, to help check when the beans were perfectly done—coffee beans make a popping sound when ready. Roasting standards were exacting. After roasting and cooling, the coffee was immediately vacuum-sealed in bags that preserved freshness for up to 26 weeks. As a matter of policy, however, Starbucks removed coffees on its shelves after three months and, in the case of coffee used to prepare beverages in stores, the shelf life was limited to seven days after the bag was opened.

In 2018, Starbucks had multiple roasting plants in numerous locations, having expanded its roasting operations as its store base expanded to more geographic regions and countries. Roasting plants also had additional space for warehousing and shipping coffees. In keeping with Starbucks' corporate commitment to reduce its environmental footprint, since 2009 all newly built roasting plants had conformed to LEED (Leadership in Energy and Environment Design) standards devised by the United States Green Building Council; LEED standards were the most widely used green building rating system in the world for evaluating the environmental performance of a building and encouraging market transformation towards sustainable design. Starbucks had launched an initiative to achieve LEED certification for all company-operated facilities by the end of 2010, and facilities constructed prior to 2010 were remodeled and/or retrofitted accordingly.[27]

STARBUCKS' CORPORATE SOCIAL RESPONSIBILITY STRATEGY

Howard Schultz's effort to "build a company with soul" included a long history of doing business in ways that were socially and environmentally responsible. A commitment to do the right thing had been central to how Starbucks operated since Howard Schultz first became CEO in 1987, and one of the core beliefs at Starbucks was that "the way to build a great, enduring company is to strike a balance between profitability and a social conscience." The specific actions comprising Starbucks' social responsibility strategy had varied over the years but the intent of the strategy was consistently one of contributing positively to the communities in which Starbucks had stores, being a good environmental steward, and conducting the company's business in ways that earned the trust and respect of customers, partners/employees, suppliers, and the general public.

In 2018, Starbucks' corporate social responsibility (CSR) strategy had five main elements:

1. *Ethically sourcing all of its products*—This CSR element had two main pieces: (a) all of the company's actions and collaborative efforts in purchasing the company's supplies of coffee, tea, and cocoa that were aimed at providing loans and technical assistance to the small family farms that grew these products, paying prices for these products that improved the living standards and economic well-being of the farmers and their communities, and trying to institute better soil-management and sustainable farming practices; and (b) striving to buy the manufactured products and services it needed from suppliers who not only adhered to strict food safety and product quality standards, and certain Starbucks-specified operating practices, but also signed an agreement pledging compliance with the company's global Supplier Code of Conduct. This code of conduct included:
   - Demonstrating commitment to the welfare, economic improvement, and sustainability of the people and places that produce products and services for Starbucks.
   - Adherence to local laws and international standards regarding human rights, workplace safety, and worker compensation and treatment.

- Meeting or exceeding national laws and international standards for environmental protection and minimizing negative environmental impacts of the supplier's operations.
- Commitment to measuring, monitoring, reporting, and verification of compliance to this code.
- Pursuing continuous improvement of these social and environmental principles.[28]

Verification of compliance was subjects to audits by Starbucks personnel or acceptable third parties. From time to time, Starbucks had temporarily or permanently discontinued its business relationship with suppliers who failed to comply or failed to work with Starbucks to correct a noncomplying situation.

2. *Community involvement and corporate citizenship*—Active engagement in community activities and display of good corporate citizenship had always been core elements in the way Starbucks conducted its business. Starbucks stores and employees regularly volunteered for community improvement projects and initiatives that would have a meaningful impact on the localities in which Starbucks had a presence. In fiscal 2011 Starbucks sponsored a special global month of service in which more than 60,000 employees in 30 countries volunteered for over 150,000 service hours and completed 1,400 community-service projects; every year since, Starbucks had held a Global Month of Service.

   The company had a goal of having 100 percent of its stores worldwide participating in community service projects. Recently, through a strategic alliance with Feeding America, Starbucks had instituted a "food share" program to rescue food that would otherwise spoil in its stores to donate to organizations providing meals to needy families and homeless people. Management estimated that when the program was fully operational in all Starbucks stores that the food donations would help provide 50 million meals per year.

3. *Environmental stewardship*—Initiatives here included a wide variety of actions to increase recycling, reduce waste, be more energy efficient, use renewable energy sources, conserve water resources, make all company facilities as green as possible by using environmentally friendly building materials and energy efficient designs, and engage in more efforts to address climate change. Beginning in January 2011, all new company-owned retail stores globally were built to achieve LEED certification; as of 2015 Starbucks had built more than 1,200 LEED-certified stores in 20 countries. In 2008, Starbucks set a goal of reducing water consumption by 25 percent in company-owned stores by 2015, and after two years had implemented proactive measures that had decreased water use by almost 22 percent. Starbucks had invested in renewable energy since 2005, and it achieved a milestone in 2015 by purchasing the equivalent of 100 percent of the electricity consumption of all company-operated stores worldwide from renewable energy sources, primarily utilizing Renewable Energy Credits from the United States and Canada and through green electricity-supply contracts across Europe. Starbucks was the number one purchaser of renewable electricity in its sector on the EPA's Green Power Partnership National Top 100 list. Starbucks had a program in place to achieve a 25 percent reduction in energy use by 2015. By 2011, nearly 80 percent of company-owned Starbucks stores in North America were recycling cardboard boxes and other back-of-store items; there were front-of-store recycling bins in place in all company-owned locations where there were municipal recycling capabilities (50 percent of company-owned stores in the United States as of year-end 2015). Since 1985, Starbucks had given a $0.10 discount to customers who brought reusable cups and tumblers to stores for use in serving the beverages they ordered. In 2018, a program was in place to double the recycled content, recyclability, and reusability of the cups in which beverages were served, and an initiative had been launched to empower 10,000 Starbucks employees to be "sustainability champions" by 2020. Stores participated in Earth Day activities each year with in-store promotions and volunteer efforts to educate employees and customers about the impacts their actions had on the environment.

4. *Creating opportunities to help people achieve their dreams.* The chief initiatives here included hiring 100,000 young people aged 16 to 24 who were disconnected from work and school by 2020, hiring at least 25,000 veterans and military spouses by 2025, welcoming and employing 10,000 refugees across the 75 countries in which Starbucks stores were located, expanding partner participation

in the company's college achievement plan that covered full tuition reimbursement for admission to one of Arizona State University's online degree programs, and making ongoing "Youth Opportunity" grants to support mentoring, work placement, and apprenticeship programs.

5. *Charitable contributions*—The Starbucks Foundation, set up in 1997, oversaw a major portion of the company's philanthropic activities; it received the majority of its funding from Starbucks Coffee Company and private donations. Over the years, the Starbucks Foundation had made close to 200 grants to nonprofit organizations such as the American Red Cross for relief efforts to communities experiencing severe damage from earthquakes, hurricanes, tornadoes, floods, and other natural disasters, Save the Children for efforts to improve education, health, and nutrition, the Global Fund and Product (RED)™ to provide medicine to people in Africa with AIDS, and a wide assortment of community-building efforts. Donations were made in cash and in-kind contributions. In 2017, the foundation made grants ranging from $10,000 to $100,000 to more than 40 nonprofits in 27 U.S. cities, plus others to various communities across the world.[29]

Water, sanitation, and hygiene education programs in water-stressed countries were supported through the Starbucks Foundation's Ethos Water Fund. For each bottle of Ethos water purchased at Starbucks stores, Starbucks donated $0.05 ($0.10 in Canada) to the Ethos© Water Fund. Since 2005, the Fund had made over $15 million in grants, benefitting more than 500,000 people around the world.

Starbucks had been named to *Corporate Responsibility Magazine*'s list of the 100 Best Corporate Citizens on numerous occasions; this list was based on more than 360 data points of publicly available information in seven categories: environment, climate change, human rights, philanthropy, employee relations, financial performance, and governance. Over the years, Starbucks had received over 25 awards from a diverse group of organizations for its philanthropic, community service, and environmental activities.

An Embarrassing Incident at a Starbucks Store In April 2018, Starbucks suffered a public relations disaster when a Starbucks manager in Philadelphia called the police a few minutes after two black men arrived at a store and sat waiting for a friend. They had not yet purchased anything when the police were called. After police arrived they arrested the two men. Social media erupted and the incident was widely covered by the media. After investigating what happened, Starbucks determined that insufficient support and training, bias, and a company policy that defined customers as paying patrons—versus anyone who enters a store—led to the decision to call the police. Starbucks president met with the two men to express the company's apologies, reconcile, and commit to actions to reaffirm the company's mission and enduring values to create a welcoming environment. The company further decided it would close more than 8,000 company stores for three hours on the afternoon of May 29 to conduct bias awareness training for 175,000 Starbucks partners, share life experiences, listen to experts, reflect on the realities of bias in society, and talk about how to create store spaces where everyone would feel like they belong.

TOP MANAGEMENT CHANGES: CHANGING ROLES FOR HOWARD SCHULTZ

In 2000, Howard Schultz decided to relinquish his role as CEO, retain his position as chairman of the company's board of directors, and assume the newly created role of chief strategic officer. Orin Smith, a Starbucks executive who had been with the company since its early days, was named CEO. Smith retired in 2005 and was replaced as CEO by Jim Donald who had been president of Starbucks' North American division. In 2006, Donald proceeded to set a long-term objective of having 40,000 stores worldwide and launched a program of rapid store expansion in an effort to achieve that goal.

But investors and members of Starbucks' board of directors (including Howard Schultz) became uneasy about Donald's leadership of the company when the company's stock price drifted downward through much of 2007, customer traffic in Starbucks stores in the United States began to erode in 2007, and Donald kept pressing for increased efficiency in store operations at the expense of good customer service. In January 2008, the Starbucks board asked Howard Schultz to return to his role as CEO and lead a major restructuring and revitalization initiative.

Schultz immediately revamped the company's executive leadership team and changed the roles and responsibilities of several key executives.[30] Believing that Starbucks had become less passionate about customer relationships and the coffee experience that had fueled the company's success, Schultz hired a former Starbucks executive to fill the newly created position of chief creative officer responsible for elevating the in-store experience of customers and achieving new levels of innovation and differentiation. He then proceeded to launch a series of actions to recast Starbucks into the company he envisioned it ought to be, push the company to new plateaus of differentiation and innovation, and prepare for renewed global expansion of Starbucks retail store network. This transformation effort, which instantly became the centerpiece of his return as company CEO, had three main themes—strengthen the core, elevate the experience, and invest and grow.

In 2010, as part of Schultz's "invest and grow" aspect of transforming Starbucks, the company began formulating plans to open thousands of new stores in China over time.[31] Japan had long been Starbucks biggest foreign market outside North America, but Howard Schultz said that, "Asia clearly represents the most significant growth opportunity on a go-forward basis."[32] Schultz's transformation effort was a resounding success, with more than 10,000 stores being opened during fiscal years 2011 to 2017 and impressive gains in revenues and profits. During fiscal year 2018, Starbucks was opening stores in China at the rate of 1 every 15 hours; headed into June 2018, the company had more than 3,300 stores across 141 cities in China and was serving more than 6.4 million customers a week. Shanghai alone had over 600 Starbucks stores, more than any other city in the world. Starbucks goal was to have 5,000 stores in China by 2021.

In April 2017, following a December 2016 announcement, Howard Schultz officially stepped down as Starbucks CEO, turning the role over to Kevin Johnson, Starbucks chief operating officer with whom Schultz had worked closely for the past two years—they had adjoining offices connected by a door and usually visited together multiple times a day. Schultz stayed on as chairman of the company's board of directors and focused his time on social initiatives and plans for the upscale Roastery Reserve brand. Schultz exuded confidence that Johnson was the right person to lead Starbucks in the future and that he was well prepared to meet the challenges of continuing to build the Starbucks brand, enhance the consumer experience, and manage its global operations.

Then, in a surprise announcement on June 4, 2018, Schultz at the age of 64 announced that he was resigning as Starbucks executive chairman and member of the board of directors effective June 26, thus ending his career at Starbucks. According to Starbucks, his honorary title would be chairman emeritus. In interviews with the media, Schultz indicated that he would be writing a book and exploring a number of options from philanthropy to public service. There was immediate speculation that he would run for President of the United States in 2020; on numerous occasions, he had expressed his disagreement with many policies of the Trump Administration.

ENDNOTES

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