CASE 23

Starbucks' Strategy and Internal Initiatives to Return to Profitable Growth

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Since its founding in 1987 as a modest nine-store operation in Seattle, Washington, Starbucks had become the world's premier roaster and retailer of specialty coffees, with 8,812 company-owned stores and 7,852 licensed stores in more than 50 countries as of April 2010 and annual sales of about $10 billion. But the company's 2008–2009 fiscal years were challenging. Sales at company-owned Starbucks stores open 13 months or longer declined an average of 3 percent in 2008 and another 5 percent in 2009. Company-wide revenues declined from $10.4 billion in fiscal year 2008 to $9.8 billion in fiscal year 2009. During fiscal 2009, Starbucks closed 800 underperforming company-operated stores in the United States and an additional 100 stores in other countries, restructured its entire operations in Australia (including the closure of 61 stores), and reduced the number of planned new store openings by more than 200. Starbucks' global workforce was trimmed by about 6,700 employees. The company's cost-reduction and labor-efficiency initiatives resulted in savings of about $580 million. Exhibit 1 shows the performance of Starbucks' company-operated retail stores for the most recent five fiscal years.

In his November 2009 letter to company shareholders, Howard Schultz, Starbucks' founder, chairman of the board, and chief executive officer, said:

> Two years ago, I expressed concern over challenges confronting our business of a breadth and magnitude unlike anything I had ever seen before. For the first time, we were beginning to see traffic in our U.S. stores slow. Strong competitors were entering our business. And perhaps most troublesome, where in the past Starbucks had always been forward-thinking and nimble in its decision-making and execution, like many fast-growing companies before us, we had allowed our success to make us complacent.
>
> It was obvious to me, and to our leadership team, that Starbucks needed nothing less than a full-fledged transformation to return to profitable growth. Our blueprint for change was the transformation agenda: improving the state of our business through better training, tools, and products; renewing our attention to store-level economics and operating efficiency; reigniting our emotional attachment with customers; and realigning Starbucks' organization for the long term.
>
> Since then, we have worked through the multitude of challenges required to revitalize our brand and transform our company—all in the face of the worst global economic environment of our generation. Today, I am pleased to report that we have made and continue to make significant progress in transforming Starbucks and returning the company to sustainable, profitable growth while preserving our values and guiding principles.
>
> With our progress over the past two years, we are now in a position to take advantage of the global opportunities for Starbucks.[1]

COMPANY BACKGROUND

Starbucks Coffee, Tea, and Spice

Starbucks got its start in 1971 when three academics, English teacher Jerry Baldwin, history

Exhibit 1 Selected Operating Statistics for Starbucks Stores, Fiscal Years 2005–2009

	Fiscal Years Ending				
	Sept. 27, 2009	Sept. 28, 2008	Sept. 30, 2007	Oct. 1, 2006	Oct. 2, 2005
Net Revenues at Company-Operated Retail Stores ($ millions)					
United States	$ 6,572.1	$ 6,997.7	$ 6,560.9	$ 5,495.2	$ 4,539.5
International	1,608.0	1,774.2	1,437.4	1,087.9	852.5
Operating Income at Company-Operated Retail Stores ($ millions)					
United States	$ 531.8	$ 454.2	$ 1,005.2	$ 955.2	$ 818.5
International	92.9	110.0	137.7	108.5	82.3
Percentage Change in Sales at Company-Operated Stores Open 13 Months or Longer					
United States	−6%	−5%	4%	7%	9%
International	−2%	2%	7%	8%	6%
Worldwide average	−5%	−3%	5%	7%	8%
Average Sales Revenues at Company-Operated Retail Stores					
United States	$938,000	$970,000	$1,048,000	$1,049,000	$1,004,000
United Kingdom and Ireland	$870,000	$924,000	$ 958,000	$ 925,000	$ 853,000
Canada	$835,000	$910,000	$ 918,000	$ 870,000	$ 829,000
China	$549,000	$537,000	$ 508,000	$ 460,000	$ 447,000
All other international locations	$678,000	$681,000	$ 663,000	$ 633,000	$ 605,000
Stores Opened during the Year (net of closures)					
United States					
Company-operated stores	(474)	445	1,065	810	580
Licensed stores	35	438	723	733	596
International					
Company-operated stores	89	236	286	240	177
Licensed stores	305	550	497	416	319
Total store openings (net of closures)	(45)	1,669	2,571	2,199	1,672

Sources: Management Presentation at Barclays Capital Retail and Restaurants Conference on April 28, 2010, www.starbucks.com, accessed June 8, 2010; 2009 10-K report, p. 19 and p. 76; and 2007 10-K report, p. 70.

teacher Zev Siegel, and writer Gordon Bowker—all coffee aficionados—opened Starbucks Coffee, Tea, and Spice in the touristy Pikes Place Market in Seattle. Sharing a love for fine coffees and exotic teas, the three partners believed they could build a clientele in Seattle that would appreciate the best coffees and teas, much like what had already emerged in the San Francisco Bay area. They each invested $1,350 and borrowed another $5,000 from a bank to open the Pikes Place store. The inspiration and mentor for the Starbucks venture in Seattle was a Dutch immigrant named Alfred Peet who had opened Peet's Coffee and Tea in Berkeley, California, in 1966. Peet's store specialized in importing fine coffees and teas and dark-roasting its own beans the European way to bring out the full flavors of the beans. Customers were encouraged to learn how to grind the beans and make their own freshly brewed coffee at home. Baldwin, Siegel, and Bowker were well acquainted with Peet's expertise, having visited his store on numerous occasions and listened to him expound on quality coffees and the importance of proper bean-roasting techniques.

The Pikes Place store featured modest, handbuilt, classic nautical fixtures. One wall was devoted to whole bean coffees, while another had shelves of coffee products. The store did not offer fresh-brewed coffee sold by the cup, but tasting samples were sometimes available. Initially, Siegel was the only paid employee. He wore a grocer's apron, scooped out beans for customers, extolled the virtues of fine, dark-roasted coffees, and functioned as the partnership's retail expert. The other two partners kept their day jobs but came by at lunch or after work to help out. During the start-up period, Baldwin kept the books and developed a growing knowledge of coffee; Bowker served as the "magic, mystery, and romance man."[2] The store was an immediate success, with sales exceeding expectations, partly because of interest stirred by a favorable article in the *Seattle Times.* For most of the first year, Starbucks ordered its coffee beans from Peet's, but then the partners purchased a used roaster from Holland, set up roasting operations in a nearby ramshackle building, and came up with their own blends and flavors.

By the early 1980s, the company had four Starbucks stores in the Seattle area and had been profitable every year since opening its doors. But then Zev Siegel experienced burnout and left the company to pursue other interests. Jerry Baldwin took over day-to-day management of the company and functioned as chief executive officer; Gordon Bowker remained involved as an owner but devoted most of his time to his advertising and design firm, a weekly newspaper he had founded, and a microbrewery that he was launching known as the Redhook Ale Brewery.

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, decided to pay Starbucks a visit—he was curious about 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 taking only 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 Jerry Baldwin and Gordon Bowker, Schultz was struck by their knowledge of coffee, their commitment to providing customers with quality coffees, and their passion for educating customers about the merits of dark-roasted coffees. Baldwin told Schultz, "We don't manage the business to maximize anything other than the quality of the coffee."[3] The company purchased only the finest arabica coffees and put them through a meticulous dark-roasting process to bring out their full flavors. Baldwin explained that the cheap robusta coffees used in supermarket blends burned when subjected to dark-roasting. He also noted that the makers of supermarket blends preferred lighter roasts because it allowed higher yields (the longer a coffee was roasted, the more weight it lost).

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. It was also clear to Schultz that Starbucks was strongly committed to educating its customers to appreciate the qualities of fine coffees. 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 Starbucks enterprise. Schultz recalled, "There was something magic about it, a passion and authenticity I had never experienced in business."[4] The appeal of living in the Seattle area was another strong plus. By the time he landed at Kennedy Airport, he knew in his heart he wanted to go to work for Starbucks. At the first opportunity, Schultz asked Baldwin whether there was any way he could fit into Starbucks. While he and Baldwin had established an easy, comfortable personal rapport, it still took a year, numerous meetings at which Schultz presented his ideas, and a lot of convincing to get Baldwin, Bowker, and their silent partner from San Francisco to agree to hire him. Schultz pursued a job at Starbucks far more vigorously than Starbucks pursued hiring Schultz. The owners were nervous about bringing in an outsider, especially a high-powered New Yorker who had not grown up with the values of the company. Nonetheless, Schultz continued to press his ideas about the tremendous potential of expanding the Starbucks enterprise outside Seattle and exposing people all over America to Starbucks coffee.

At a meeting with the three owners in San Francisco in the spring of 1982, Schultz once again presented his ideas and vision for opening Starbucks stores across the United States and Canada. He thought the meeting went well and flew back to New York, believing a job offer was in the bag. However, the next day Jerry Baldwin called Schultz and indicated that the owners had decided against hiring him because geographic expansion was too risky and they did not share Schultz's vision for Starbucks. Schultz was despondent, seeing his dreams of being a part of Starbucks' future go up in smoke. Still, he believed so deeply in Starbucks' potential that he decided to make a last-ditch appeal; he called Baldwin the next day and made an impassioned, reasoned case for why the decision was a mistake. Baldwin agreed to reconsider. The next morning Baldwin called Schultz and told him the job of heading marketing and overseeing the retail stores was his. In September 1982, Howard Schultz took over his new responsibilities at Starbucks.

Starbucks and Howard Schultz, 1982–1985

In his first few months at Starbucks, Schultz spent most of his waking hours 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. By December, Jerry Baldwin concluded that Schultz was ready for the final part of his training: 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 made a point of acclimating himself to the informal dress code at Starbucks, gaining credibility and building trust with colleagues, and making the transition from the high-energy, coat-and-tie style of New York to the more casual, low-key ambience of the Pacific Northwest. Schultz made real headway in gaining the acceptance and respect of company personnel while working at the Pike Place store one day during the busy Christmas season that first year. The store was packed and Schultz was behind the counter ringing up sales of coffee when someone shouted that a shopper had just headed out the door with two coffeemakers. Without thinking, Schultz leaped over the counter and chased the thief, yelling, "Drop that stuff! Drop it!" The thief dropped both pieces and ran. Schultz returned to the store, holding the coffeemakers up like trophies. Everyone applauded. When Schultz returned to his office later that afternoon, his staff had strung up a banner that read: "Make my day."[5]

Schultz was overflowing with ideas for the company. Early on, he noticed that first-time customers sometimes felt uneasy in the stores because of their lack of knowledge about fine coffees and because store employees sometimes came across as a little arrogant or superior to coffee novices. Schultz worked with store employees on customer-friendly sales skills and developed brochures that made it easy for customers to learn about fine coffees. However, Schultz's 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 entered 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 when the trade show concluded for the day, 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. They seemed to function as an integral community gathering place, and energy levels were typically high. Each bar had its own unique character, but they all had a barista that performed with flair and established a camaraderie with 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 *caffelatte* 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 them.

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 with Baldwin and Bowker. But instead of winning their approval for trying out some of his ideas, Schultz encountered strong resistance. Baldwin and Bowker argued that Starbucks was a retailer, not a restaurant or coffee bar. They feared that 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. But a more pressing reason not to pursue Schultz's coffee bar concept emerged shortly—Baldwin and Bowker were excited by an opportunity to purchase Peet's Coffee and Tea. The acquisition was finalized in early 1984, and to fund it Starbucks had to take on considerable debt, leaving little in the way of financial flexibility to support Schultz's ideas for entering the beverage part of the coffee business or expanding the number of Starbucks stores. For most of 1984, Starbucks managers were dividing their time between operations in Seattle and the Peet's enterprise in San Francisco. Schultz found himself in San Francisco every other week supervising the marketing and operations of the five Peet stores. Starbucks employees began to feel neglected and, in one quarter, did not receive their usual bonus due to tight financial conditions. Employee discontent escalated to the point where a union election was called. The union won by three votes. Baldwin was shocked at the results, concluding that employees no longer trusted him. In the months that followed, he began to spend more of his energy on the Peet's operation in San Francisco.

It took Howard Schultz nearly a year to convince Jerry Baldwin to let him test an espresso bar. Baldwin relented when Starbucks opened its sixth store in April 1984. It was the first Starbucks store designed to sell beverages, and it was the first located in downtown Seattle. Schultz asked for a 1,500-square-foot space to set up a full-scale Italian-style espresso bar, but Baldwin agreed to allocating only 300 square feet in a corner of the new store. The store opened with no fanfare as a deliberate experiment to see what would happen. 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 Baldwin's 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 went into Baldwin's office to show him the sales figures and customer counts at the new downtown store. But Baldwin 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. Baldwin rebelled at the thought that people would see Starbucks as a place to get a quick cup of coffee to go. He adamantly told Schultz, "We're coffee roasters. I don't want to be in the restaurant business. . . . Besides, we're too deeply in debt to consider pursuing this idea."[6] While he didn't deny that the experiment was succeeding, he didn't want to go forward with introducing beverages in other Starbucks stores. Schultz's efforts to persuade Baldwin to change his mind continued to meet strong resistance, although to avoid a total impasse Baldwin finally did agree to let Schultz put espresso machines in the back of one or two 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. Baldwin and Bowker, 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, Jerry Baldwin committed to investing $150,000 of Starbucks' money in Schultz's coffee bar enterprise, thus becoming Schultz's first investor. Baldwin accepted Schultz's invitation to be a director of the new company, and Gordon Bowker agreed to be a part-time consultant for six months. Bowker, pumped up about the new venture, urged Schultz to make sure that everything about the new stores—the name, the presentation, the care taken in preparing the coffee—was calculated to elevate customer expectations and lead them to expect something better than competitors offered. Bowker proposed that the new company be named Il Giornale Coffee Company (pronounced *il jor NAHL ee*), a suggestion that Howard accepted. In December 1985, Bowker and Schultz made a trip to Italy, where they visited some 500 espresso bars in Milan and Verona, observing local habits, taking notes about decor and menus, snapping photographs, and videotaping baristas in action.

About $400,000 in seed capital was raised by the end of January 1986, 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 whom said no. Many who heard Schultz's hourlong 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 ways 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 hard-to-pronounce name turned some off. Being rejected by so many potential investors was disheartening—some who listened to Schultz's presentation didn't even bother to call him back; others refused to take his calls. 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 9 people, 5 of whom became directors.

The first II Giornale store opened in April 1986. It had 700 square feet and was located near the entrance of Seattle's tallest building. The decor 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, and many 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 the first II Giornale opened, 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 the three stores were running at a rate equal to $1.5 million annually.

Il Giornale Acquires Starbucks

In March 1987, Jerry Baldwin and Gordon Bowker decided to sell the whole Starbucks operation in Seattle—the stores, the roasting plant, and the Starbucks name. Bowker wanted to cash out his coffee business investment to concentrate on his other enterprises; Baldwin, who was tired of commuting between Seattle and San Francisco, wanted to concentrate on the Peet's operation. As he recalls, "My wife and I had a 30-second conversation and decided to keep Peet's. It was the original and it was better."[7]

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. While a rival plan to acquire Starbucks was put together by another Il Giornale investor, Schultz's proposal prevailed and 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 following Monday morning, Howard 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."[8]

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 indicated that he wanted to include people in the decision-making process and that he would be open and honest with them.

Schultz believed that 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. His aspiration was for Starbucks to become the most respected brand name in coffee and for the company to be admired for its corporate responsibility. In the next few days and weeks, Schultz came to see that the unity and morale at Starbucks had deteriorated badly in the 20 months he had been at Il Giornale. Some employees were cynical and felt unappreciated. There was a feeling that prior management had abandoned them and a wariness about what the new regime would bring. Schultz decided to make building a new relationship of mutual respect between employees and management a priority.

The business plan Schultz had presented investors called for the new 9-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 whom 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. When Starbucks' key roaster and coffee buyer resigned, Schultz put Dave Olsen in charge of buying and roasting coffee. Lawrence Maltz, who had 20 years' experience in business and 8 years' experience as president of a profitable public beverage company, was hired as executive vice president and charged with heading operations, finance, and human resources.

In the next several months, a number of changes were instituted. 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 became Starbucks' signature.

By December 1987, the mood of the employees at Starbucks had turned upbeat. They were buying into the changes that Schultz was making, and trust began 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

Starbucks' entry into Chicago proved far more troublesome than management anticipated. The first Chicago store opened in October 1987, and three more stores were opened over the next six months. Customer counts at the stores were substantially below expectations. Chicagoans did not take to dark-roasted coffee as fast as Schultz had anticipated. The first downtown store opened onto the street rather than into the lobby of the building where it was located; in the winter months, customers were hesitant to go out in the wind and cold to acquire a cup of coffee. It was 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 used vacuum packaging techniques with a one-way valve to allow carbon dioxide to escape without allowing air and moisture in). Rents were higher in Chicago than in Seattle, and so were wage rates. 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 mangers 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. By 1991, the Chicago stores had become profitable and the company was ready for its next big market entry. Management decided on California because of its host of neighborhood centers and the receptiveness of Californians to innovative, high-quality food. Los Angeles was chosen as the first California market to enter, principally because of its status as a trendsetter and its cultural ties to the rest of the country. L.A. consumers embraced Starbucks quickly, and the *Los Angeles Times* named Starbucks as the best coffee in America before the first store opened. The entry into San Francisco proved more troublesome because San Francisco had an ordinance against converting stores to restaurant-related uses in certain prime urban neighborhoods; Starbucks could sell beverages and pastries to customers at stand-up counters but could not offer seating in stores that had formerly been used for general retailing. However, the city council was soon convinced by café owners and real estate brokers to change the code. Still, Starbucks faced strong competition from Peet's and local espresso bars in the San Francisco market.

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 him 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.[9]

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 down the road. His arguments carried the day with the board and with investors, especially since revenues were growing by approximately 80 percent annually and customer traffic at the stores was meeting or exceeding expectations.

Starbucks became profitable in 1990. Profits had increased every year since 1990 except for fiscal year 2000 (because of a $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). Because of the economic downturn in 2008–2009, Howard Schultz believed that new strategic initiatives and rejuvenated strategy execution efforts were very much needed at Starbucks. Exhibit 2 provides a summary of the company's financial performance for fiscal years 2005–2009. Exhibit 3 shows the long-term performance of the company's stock price; the stock had split 2-for-1 five times.

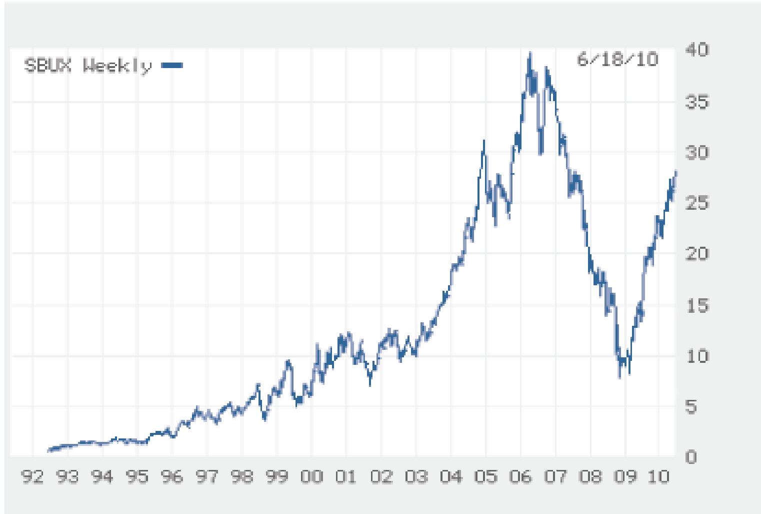
Exhibit 2 Financial Summary for Starbucks Corporation, Fiscal Years 2005–2009 ($ billions, except for per share amounts)

	Fiscal Years Ending*				
	Sept. 27, 2009	Sept. 28, 2008	Sept. 30, 2007	Oct. 1, 2006	Oct. 2, 2005
Results of Operations Data					
Net revenues:					
Company-operated retail store revenues	$8,180.1	$ 8,771.9	$7,998.3	$ 6,583.1	$ 5,391.9
Specialty revenues:					
Licensing	1,222.3	1,171.6	1,026.3	860.6	673
Foodservice and other	372.2	439.5	386.9	343.2	304.4
Total specialty revenues	1,594.5	1,611.1	1,413.2	1,203.8	977.4
Total net revenues	$9,774.6	$10,383.0	$ 9,411.5	$ 7,786.9	$6,369.3
Cost of sales, including occupancy costs	4,324.9	4,645.3	3,999.1	3,178.8	2,605.2
Store operating expenses	3,425.1	3,745.3	3,215.9	2,687.8	2,165.9
Other operating expenses	264.4	330.1	294.2	253.7	192.5
Depreciation and amortization expenses	534.7	549.3	467.2	387.2	340.2
General and administrative expenses	453.0	456.0	489.2	479.4	361.6
Restructuring charges	332.4	266.9	—	—	—
Total operating expenses	9,334.5	9,992.7	8,465.6	6,986.9	5,665.4
Income from equity investees	121.9	113.6	108.0	93.9	76.6
Operating income	$ 562.0	$ 503.9	$1,053.9	$ 894.0	$ 780.5
Earnings before cumulative effect of change in accounting principle	390.8	315.5	672.6	581.5	494.4
Cumulative effect of accounting change for asset retirement obligations, net of taxes	—	—	—	17.2	—
Net earnings	$ 390.8	$ 315.5	$ 672.6	$ 564.3	$ 494.4
Net earnings per common share—diluted	$0.52	$0.43	$0.87	$0.71	$0.61
Balance Sheet Data					
Current assets	$2,035.8	$ 1,748.0	$1,696.5	$1,529.8	$1,209.3
Current liabilities	1,581.0	2,189.7	2,155.6	1,935.6	1,227.0
Total assets	5,576.8	5,672.6	5,343.9	4,428.9	3,513.7
Short-term borrowings	—	713	710.3	700	277
Long-term debt (including current portion)	549.5	550.3	550.9	2.7	3.6
Shareholders' equity	$3,045.7	$ 2,490.9	$2,284.1	$2,228.5	$2,090.3
Cash Flow Data					
Net cash provided by operating activities	$1,389.0	$1,258.7	$ 1,331.2	$ 1,131.6	$922.9
Capital expenditures (net additions to property, plant and equipment)	$445.6	$984.5	$1,080.3	$771.2	$643.3

*The company's fiscal year ended on the Sunday closest to September 30.

Source: Starbucks, 2009, 2007 and 2005 10-K reports.

Exhibit 3 **The Performance of Starbucks' Stock, 1993–2010**



Source: Wall Street Journal, http://online.wsj.com, accessed June 18, 2010.

STARBUCKS STORES: DESIGN, AMBIENCE, AND EXPANSION OF LOCATIONS

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 didn't buy real estate or build its own freestanding structures; rather, each space was leased in an existing structure, making each store differ in 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. Only a select few were in suburban malls.

A "stores of the future" project team was formed in 1995 to raise Starbucks' store design to a still higher level and come up with the next generation of Starbucks stores. The team came up with four store designs—one for each of the four stages of coffeemaking: growing, roasting, brewing, and aroma—each with its own color combinations, lighting scheme, and component materials. Within each of the four basic store templates, Starbucks could vary the materials and details to adapt to different store sizes and settings (downtown buildings, college campuses, neighborhood shopping areas). In late 1996, Starbucks began opening new stores based on one of four formats and color schemes.

But as the number of stores increased rapidly between 2000 and 2003, greater store diversity and layout quickly became necessary. Some stores had 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. The company also experimented with drive-through windows in locations where speed and convenience were important to customers and with kiosks in supermarkets, building lobbies, and other public places. In recent years, Starbucks had begun emphasizing drive-through retail stores in order to provide a greater degree of access and convenience for nonpedestrian customers. At the end of fiscal 2009, Starbucks had around 2,650 drive-through locations.[10]

In June 2009, Starbucks announced a new global store design strategy. Each new store was to be a reflection of the environment in which it operated and was to be environmentally friendly. In 2010, Starbucks began an effort to achieve Leadership in Energy and Environmental Design (LEED) certification for all new company-owned stores. (LEED certification was a program that used independent third parties to certify that a building incorporated green building design, construction, operations, and maintenance solutions.)[11] Core characteristics of each new store included celebration of local materials and craftsmanship, a focus on reused and recycled elements, exposure of structural integrity and authentic roots, elevation of coffee and removal of unnecessary distractions, storytelling and customer engagement through all five senses, and flexibility to meet the needs of many customer types.[12] Exhibit 4 shows the diverse nature of Starbucks stores.

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.

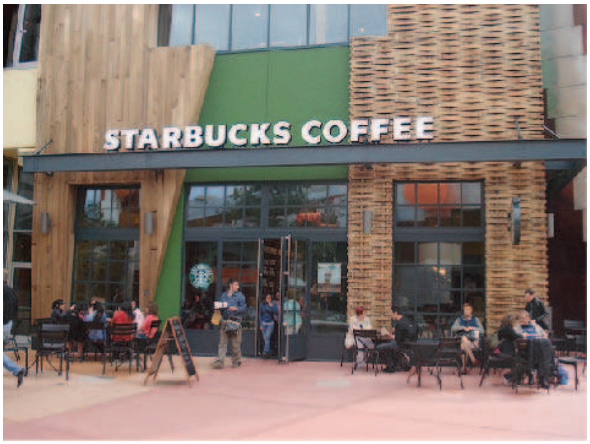
Store Ambience

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 that 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; that signaled the company's passion for coffee; that enhanced the mood and ambience of the store; and that rewarded customers with ceremony, stories, surprise, and a satisfying experience. The thesis was 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.

To try to keep the coffee aromas in the stores pure, Starbucks banned smoking and asked employees to refrain from wearing perfumes or colognes. Prepared foods were kept covered so that customers would smell coffee only. Colorful banners and posters were used to keep the look of Starbucks stores fresh and to highlight seasons and holidays. Company designers came up with artwork for commuter mugs and T-shirts in different cities that were in keeping with each city's personality (peach-shaped coffee mugs for Atlanta, pictures of Paul Revere for Boston and the Statue of Liberty for New York).

In August 2002, Starbucks teamed up with T-Mobile USA to experiment with providing Internet access and enhanced digital entertainment to patrons at more than 1,200 Starbucks locations. 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. Since the August 2002 introduction of Wi-Fi at Starbucks, wireless Internet service had been added at most company-operated stores in the United States. In an effort to better bridge Starbucks' "third place" coffeehouse experience with digital and social media, Starbucks announced that, beginning July 1, 2010, it would provide free Wi-Fi one-click Internet service through AT&T in all company-operated stores in the United States. There were also plans for a new online customer experience called the Starbucks Digital Network, in partnership with Yahoo, to debut in the fall of 2010 in U.S. company-operated Starbucks stores. This online experience would provide customers with free unrestricted access—via laptop, e-reader, or smartphone—to various paid sites and services such as the *Wall Street Journal*'s site

Exhibit 4 Scenes from Starbucks Stores



(**www.wsj.com**), exclusive content and previews, free downloads, and local community news and activities.

Store Expansion Strategy

In 1992 and 1993, Starbucks developed a three-year geographic expansion strategy to target areas that not only had favorable demographic profiles but 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 in the first 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 instilled the Starbucks culture in the newly opened stores.

In recent years, Starbucks' strategy in major metropolitan cities had been 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 that 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 with \$700,000 in 1995 and only \$427,000 in 1990. The steady 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 the strategy of blanketing metropolitan areas with stores had cannibalized sales of existing stores to such an extent that average sales per store in the United States had dropped to around \$1 million annually. Starbucks' long-term profitability target for its retail stores in the United States was an operating profit margin in the high teens—the operating margin was 14.3 percent in fiscal 2007, but declining store sales and depressed economic conditions had driven the margins down to 6.0 percent in fiscal 2008 and 7.5 percent in fiscal 2009.

One of Starbucks' core competencies was identifying good retailing sites for its new stores. The company was regarded as having the best real estate team in the coffee bar industry and a sophisticated system for identifying 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 Retail Stores In 1995, Starbucks began entering into licensing agreements for store locations in areas where it did not have ability to locate its own 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 licensing permitted tighter controls over the operations of licensees.

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. As of 2009, there were 4,364 licensed stores in the United States and 3,439 licensed stores internationally.

International Expansion In markets outside the continental United States (including Hawaii), Starbucks had a two-pronged store expansion: 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 used a local partner/licensee to help it recruit talented individuals, set up supplier relationships, locate suitable store sites, and cater 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. As of September 2009, Starbucks had company-operated and licensed stores in 50 countries (see Exhibit 5) and expected to open 200 new stores internationally in fiscal 2010.

Starbucks' long-term profitability target for its international operations was an operating profit margin in the mid-to-high teens. But the margins in recent years had been far below the

Exhibit 5 Company-Operated and Franchised Starbucks Stores

A. Number of Starbucks Store Locations Worldwide, 1987–March 2010 (selected years)

	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	1,217	2,435	1,671	10,241
2006	5,728	1,457	3,168	2,087	12,440
2007	6,793	1,743	3,891	2,584	15,011
2008	7,238	1,979	4,329	3,134	16,680
2009	6,764	2,068	4,364	3,439	16,635
March 28, 2010	6,736	2,076	4,385	3,467	16,664

B. International Starbucks Store Locations at End of Fiscal Year 2009

International Locations of Company-Operated Starbucks Stores		International Locations of Licensed Starbucks Stores					
		Americas		Asia-Pacific		Europe/Africa/Middle East	
Canada	775	Canada	262	Japan	875	Turkey	123
United Kingdom	666	Mexico	261	South Korea	288	United Arab Emirates	91
China	191	Other	69	China	283	Spain	76
Germany	144			Taiwan	222	Greece	69
Thailand	131			Philippines	160	Saudi Arabia	68
Singapore	64			Malaysia	118	Kuwait	62
Australia	23			Indonesia	74	France	52
Other	74			New Zealand	42	Switzerland	47
Total	2,068					United Kingdom	46
						Other	151
						Licensed total worldwide	3,439

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

Source: Starbucks, 10-K reports, various years, and company records.

target: 8.1 percent in fiscal 2007, 5.2 percent in fiscal 2008, and 4.5 percent in fiscal 2009.

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

In the mid-1990s, thinking it was time for Starbucks to move out into mainstream markets, Howard Schultz led what proved to be an ongoing series of initiatives 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 strategy was to make Starbucks products more accessible to both existing and new customers where they worked, traveled, shopped, and dined and to find and promote new occasions for enjoying Starbucks products. 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 products 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. There was much internal debate at Starbucks about whether it made sense for Starbucks coffee to be served on all United flights (since there was different coffeemaking equipment on different planes) and the possible damage to the integrity of the Starbucks brand if the quality of the coffee served did not measure up. It took seven months of negotiations for Starbucks and United to arrive at a mutually agreeable way to handle quality control on United's various types of planes. The specialty sales group also won accounts at Hyatt, Hilton, Sheraton, Radisson, and Westin hotels, resulting in packets of Starbucks coffee being in each room with coffeemaking equipment. Starbucks entered into an agreement with Wells Fargo to provide coffee service at some of the bank's locations in California. 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 health care institutions, and other such enterprises. In fiscal 2009, Starbucks generated revenues of $372.2 million from providing whole bean and ground coffees and assorted other Starbucks products to some 21,000 food service accounts.

The second initiative came in 1994 when PepsiCo and Starbucks entered into a joint venture (now called the North American Coffee Partnership) to create new coffee-related products in bottles or cans for mass distribution through Pepsi channels. Howard Schultz saw the venture with PepsiCo as a major paradigm shift with the potential to cause Starbucks' business to evolve in heretofore unimaginable directions. The joint venture's first new product, Mazagran, 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 that Starbucks had begun serving at its retail stores in the summer of 1995 and that quickly became a big hot-weather seller. Pepsi executives were enthusiastic. After months of experimentation, the joint venture product research team came up with a shelf-stable version of Frappuccino that tasted quite good. It was tested in West Coast supermarkets in the summer of 1996; sales ran 10 times projections, with 70 percent being repeat business. Sales of Frappuccino ready-to-drink beverages reached $125 million in 1997 and achieved national supermarket penetration of 80 percent. Starbucks' management believed that the market for Frappuccino would ultimately exceed $1 billion. The company began selling ready-to-drink Frappuccino products in Japan, Taiwan, and South Korea in 2005 chiefly through agreements with leading local distributors; the ready-to-drink beverage market in these countries represented more than $10 billion in annual sales.[13] In 2007, the PepsiCo-Starbucks partnership introduced a line of chilled Starbucks Doubleshot espresso drinks in the United States. Also in 2007, PepsiCo and Starbucks entered into a second joint venture called the International Coffee Partnership (ICP) for the purpose of introducing Starbucks-related beverages in country markets outside North America; one of the ICP's early moves was to begin marketing Frappuccino in China.[14] As of 2010, sales of Frappuccino products worldwide had reached $2 billion annually.[15]

In 2008, Starbucks partnered with Suntory to begin selling chilled ready-to-drink Doubleshot drinks in Japan. In 2010, Starbucks partnered with Arla Foods to begin selling Doubleshot products and Starbucks Discoveries chilled cup coffees in retail stores (as well as in Starbucks retail stores) across the United Kingdom.

In October 1995, Starbucks partnered with Dreyer's Grand Ice Cream to supply coffee extract for a new line of coffee ice cream made and distributed by Dreyer's under the Starbucks brand. By July 1996, Starbucks coffee-flavored ice cream was the number-one-selling superpremium brand in the coffee segment. 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 considered 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. Seven flavors of Starbucks ice cream and two flavors of novelty bars were marketed in 2010. Pints were available in the freezer sections at supermarkets for a suggested retail price of $3.99; the novelty bars sold for a suggested retail price of $2.49 and were also available in many convenience stores.

In 1997, a Starbucks store manager who had worked in the music industry and selected the music Starbucks played as background in its stores suggested that Starbucks begin selling the background music on tapes (and later on CDs as they become the preferred format). The manager had gotten compliments from customers wanting to buy the music they heard and suggested to senior executives that there was a market for the company's handpicked music. Research through two years of comment cards turned up hundreds asking Starbucks to sell the music it played in its stores. The Starbucks tapes/CDs proved a significant seller as an addition to the company's product line. In 2000, Starbucks acquired Hear Music, a San Francisco–based company, to give it added capability in enhancing its music CD offerings. In 2004, Starbucks introduced Hear Music media bars, a service that offered custom CD burning at select Starbucks stores. Later, Starbucks began offering customers the option of downloading music from the company's 200,000+ song library and, if they wished, having the downloaded songs burned onto a CD for purchase.

In the spring of 2008, Starbucks, in partnership with Apple's iTunes, began offering a Pick of the Week music card at its 7,000 stores in the United States that allowed customers to download each week's music selection at iTunes.[16] In 2010, Starbucks was continuing to offer CDs with handpicked music and new CDs featuring particular artists, all managed by Starbucks Entertainment in conjunction with Concord Music Group (which began managing the Hear Music Record Label in 2008); the CDs were typically priced at $12.95. Starbucks also had established a relationship with the William Morris Agency to identify books that it could offer for sale in its stores. Over the years, Starbucks' successes in music and books had included eight Grammy Awards and three number one books on the *New York Times* best-seller list.

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 the United Kingdom and Europe. 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.[17]

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 line of superpremium Tazo teas, Starbucks expanded its agreement with Kraft to market and distribute Tazo teas worldwide. In August 2008, Starbucks entered into an agreement with PepsiCo and Unilever (Lipton Tea was one of Unilever's leading brands) to manufacture, market, and distribute Starbucks' superpremium Tazo Tea ready-to-drink beverages (including iced teas, juiced teas, and herbal-infused teas) in the United States and Canada. The Tazo line of ready-to-drink beverages was to become part of an existing venture between PepsiCo and Unilever (the Pepsi/Lipton Tea partnership) that was the leading North American distributor of ready-to-drink teas.

In 2001, Starbucks introduced the Starbucks Card, a reloadable card that allowed customers to pay for their purchases with a quick swipe at the cash register and also to earn and redeem rewards. In 2009, about 15 percent of customer purchases at Starbucks stores were made on Starbucks cards.

In 2003, Starbucks acquired Seattle's Best Coffee, an operator of Seattle's Best coffee shops and marketer of Seattle's Best whole bean and ground coffees, for $70 million. Starbucks continued to operate Seattle's Best as a separate subsidiary. As of May 2008, there were more than 540 Seattle's Best cafés in the United States (a number of which were in Borders book and music stores) and 86 Seattle's Best Coffee Express espresso bars. The Seattle's Best product line included more than 30 whole bean and ground coffees (including flavored, organic, and Fair Trade Certified coffees), espresso beverages, signature handcrafted JavaKula blended beverages, OvenSong bakery food and sandwiches, and select merchandise. Shortly after the acquisition, Starbucks expanded its licensing arrangement with Kraft Foods to include marketing and distributing Seattle's Best whole bean and ground coffees in grocery and mass merchandise channels in North America, with Starbucks to receive a royalty on all such sales. In 2009, Seattle's Best whole bean and ground coffee blends were available nationwide in supermarkets and were being served at more than 15,000 food service 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 in major grocery and convenience stores in the western United States; the manufacture, marketing, and distribution of the new Seattle's Best beverages was managed by PepsiCo as part of the long-standing Starbucks-PepsiCo joint venture for ready-to-drink Frappuccino products. In May 2010, Starbucks announced that it would relaunch Seattle's Best Coffee with new distinctive red packaging and a red logo, boost efforts to open more franchised Seattle's Best cafés, and expand the availability of Seattle's Best coffees to 30,000 distribution points by October 2010. By July 2010, freshly brewed and iced Seattle's Best Coffee drinks were being sold at 7,250 Burger King outlets in the United States, 9,000 Subway locations, and some 299 AMC movie theaters in five countries.

In 2004 Starbucks teamed with Jim Beam Brands to invent a Starbucks Coffee Liqueur that would be sold be sold in bars, liquor stores, and restaurants; projections were for systemwide gross sales of more than $8 million annually. Launched in February 2005, Starbucks Coffee Liqueur was the number-one-selling new spirit product year-to-date through August 2005, according to Nielsen. In October 2005, again collaborating with Jim Beam Brands, Starbucks introduced Starbucks Cream Liqueur, a blend of cream, spirits, and a hint of Starbucks coffee. There were an estimated 22 million cordial consumers in the U.S. market, making the cream liqueur category nearly three times the size of coffee liqueur category. Both Starbucks Coffee Liqueur and Starbucks Cream Liqueur were packaged in 750 milliliter bottles priced at $22.99.

In April 2005, Starbucks acquired Ethos Water for $8 million in cash. The acquisition was made to expand the line of beverages in Starbucks stores in the United States. Following the acquisition, the brand also became known for its campaign to raise $10 million by donating $0.05 of the retail price of each bottle sold to a charitable organization working to increase access to clean drinking water and conduct sanitation and hygiene education programs in developing countries in Africa and Asia; in 2010, more than $6 million had been raised.[18] The production, distribution, and marketing of Ethos water products was handled by PepsiCo, as part of its long-standing joint venture with Starbucks.

In response to customer requests for more wholesome food and beverage options and also to bring in business from non–coffee drinkers, Starbucks in 2008 began offering fruit cups, yogurt parfaits, skinny lattes, banana walnut bread (that was nearly 30 percent real banana), a 300-calorie farmer's market salad with all-natural dressing, and a line of "better-for-you" smoothies called Vivanno Nourishing Blends. Each Vivanno smoothie averaged 250 calories and consisted of one serving of fruit, 16 grams of protein, and 5 grams of fiber.[19] Additionally, in 2009, healthier, lower-calorie selections were included in the bakery cases at Starbucks stores, and the recipes for several other food items on the menu at Starbucks stores were reformulated to include whole grains and dried fruits and to cut back on or eliminate the use of artificial flavorings, dyes, high-fructose corn syrup, and artificial preservatives.[20]

In 2008, Starbucks introduced a new coffee blend called Pike Place Roast that would be brewed every day, all day in every Starbucks store.[21] Before then, Starbucks rotated coffees 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. This reinvention of brewed coffee returned the company to the practice of grinding the beans in the store. Pike Place Roast was brewed in small batches in 30-minute intervals to ensure that customers were provided the freshest coffee possible. The Pike Place Roast was created by Starbucks' master blenders and coffee quality team using input from nearly 1,000 customers—it was smoother than any other Starbucks coffee and tasted great either black or with cream and sugar.

In the fall of 2009, Starbucks introduced Starbucks VIA Ready Brew—packets of roasted coffee in an instant form. VIA was made with a proprietary microground technology that Starbucks claimed represented a breakthrough.[22] Simply adding a packet of VIA to a cup of hot or cold water produced an instant coffee with a rich, full-bodied taste that closely replicated the taste, quality, and flavor of traditional freshly brewed coffee. Initially, VIA was introduced in Starbucks stores in the United States and Canada and select food service accounts; Starbucks stores held a four-day Starbucks VIA Taste Challenge promotional during which customers were invited to compare the difference between Starbucks VIA and fresh-brewed Starbucks coffee. During the 2009 holiday season, Starbucks VIA Ready Brew was one of the top-selling coffee products at Amazon.com. Encouraged by favorable customer response, in mid-2010 Starbucks expanded the distribution of VIA to include 25,000 grocery store, mass-merchandise store, and drugstore accounts, including Kroger, Safeway, Walmart, Target, Costco, and CVS. VIA was available in three roasts—Colombian, Italian Roast, and Decaffeinated Italian Roast; the suggested retail price for Starbucks VIA was \$2.95 for three servings and \$7.49 for eight servings. Starbucks executives saw VIA as a promising vehicle for entering the instant coffee market and attracting a bigger fraction of on-the-go and at-home coffee drinkers. Instant coffee made up a significant fraction of the coffee purchases in the United Kingdom (80 percent), Japan (53 percent), Russia (85 percent), and other countries where Starbucks stores were located—in both the UK and Japan, sales of instant coffee exceeded \$4 billion annually. Globally, the instant and single-serve coffee category was a \$23 billion market. In March 2010, Starbucks made VIA available in all of its Starbucks stores in the UK. In April 2010, Starbucks introduced VIA in all of Japan's 870 Starbucks stores under the name Starbucks VIA Coffee Essence.[23]

The company's overall retail sales mix in 2009 was 76 percent beverages, 18 percent food items, 3 percent coffeemaking equipment and other merchandise, and 3 percent whole bean coffees.[24] However, the product mix in each 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, coffeemaking equipment, filters, storage containers, and other accessories. Smaller stores and kiosks typically sold a full line of coffee beverages, a limited selection of whole bean and ground coffees and Tazo teas, and a few coffee-drinking accessories. Moreover, 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 French pastries.

Starbucks' Consumer Products Group

All distribution channels for Starbucks products outside both licensed and company-operated retail stores were collectively referred to by Starbucks executives as "specialty operations." In 2010, Starbucks formed its Consumer Products Group (CPG) to manage all specialty operations activities. CPG was responsible for selling a selection of whole bean and ground coffees as well as a selection of premium Tazo teas outside Starbucks retail stores through licensing and distribution arrangements with Kraft, PepsiCo, Unilever, and others that covered both the United States and international markets. CPG also oversaw production and sales of ready-to-drink beverages (including bottled Frappuccino beverages, Starbucks Doubleshot espresso drinks, and Discoveries chilled cup coffee) as well as Starbucks superpremium ice creams and Starbucks liqueurs through the company's marketing and distribution agreements and joint ventures with PepsiCo, Unilever, and others. And it managed the sales of various Starbucks products to both food service accounts and the vast majority of the company's partnerships and licensing arrangements with prominent third parties.

Exhibit 6 shows the recent performance of the Consumer Products Group. Starbucks executives considered CPG's specialty operations attractive from the standpoint of both long-term growth and profitability. In fiscal 2007–2009, the company's operating profit margins from specialty operations were higher than the long-term target of 35 percent and vastly superior to the operating profit margins for the company's U.S. and international operations, as the following table shows:

	Operating Profit Margins		
	FY 2009	**FY 2008**	**FY 2007**
Consumer Products Group	39.6%	37.3%	35.9%
U.S. operations	7.5	6.0	14.3
International operations	4.8	5.2	8.1

Advertising

So far, Starbucks had spent relatively little money 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. Advertising expenditures were $126.3 million in fiscal 2009, versus $129.0 million in fiscal 2008, $103.5 million in 2007, and $107.5 million in 2006. Starbucks stepped up advertising efforts in 2008 to combat the strategic initiatives of McDonald's and several other fast-food chains 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

Exhibit 6 **Performance of Starbuck's Consumer Products Group, Fiscal Years 2007–2009**

Consumer Product Group Operations	Fiscal Year 2009	2008	2007
Licensing revenues	$427.2	$392.6	$366.3
Foodservice revenues	322.4	355.0	326.1
Total revenues	$749.6	$747.6	$692.4
Operating income	$296.3	$279.2	$248.9
Operating income as a percent of total revenues	39.5%	37.3%	35.9%

Source: Starbucks, 2009 10-K report, p. 76.

biggest advertising campaign the company had ever undertaken.[25]

Vertical Integration

Howard Schultz saw Starbucks as having a unique strategy compared to the strategies pursued by its many coffeehouse competitors. He observed:

> People sometimes fail to realize that almost unlike any retailer or restaurant, we are completely vertically integrated. We source coffee from 30 countries. We have a proprietary roasting process. We distribute to company owned stores, and finally serve the coffee. Others are resellers of commodity-based coffees.[26]

HOWARD SCHULTZ'S EFFORTS TO MAKE STARBUCKS A GREAT PLACE TO WORK

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. The challenge to Starbucks, in Schultz's view, was how to attract, motivate, and reward 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 was to extend health insurance benefits to part-time workers. Their request had been turned down, but Schultz believed that expanding health insurance coverage to include part-timers was something the company needed to do. His father had recently passed away from cancer and 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 insurance plans 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 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 wouldn't 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 on to open the stores early, sometimes at 5:30 or 6:00 a.m.; others had to work until closing, usually 9:00 p.m. or later. Providing these employees with health insurance benefits, he argued, would signal that the company honored their value and contribution.

The board approved Schultz's plan, and starting in late 1988, part-timers working 20 or more hours were offered the same health coverage as full-time employees. Starbucks paid 75 percent of an employee's health insurance 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. Even when the company fell on lean times in 2008–2009, Starbucks refrained from making cuts in employee health insurance benefits; company expenditures for employee health insurance were $300 million in fiscal 2009, more than the company spent on its purchases of coffee beans.[27]

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.[28] Schultz wanted to turn all Starbucks employees into partners, 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 his or her 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 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. The value of the stock options exercised by Starbucks partners was $44 million in fiscal 2009, $50 million in fiscal 2008, and $274 million in fiscal 2007. As of September 27, 2009, Starbucks partners held 63.6 million shares in stock option awards that had a weighted-average contractual life of 6.7 years; these shares had a weighted-average exercise price of $14.75 and an aggregate value of $442.4 million.[29]

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 a 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 the each calendar quarter (the discount was 15 percent until March 2009).

Since inception of the plan, some 23.5 million shares had been purchased by partners; roughly one-third of Starbucks partners participated in the stock purchase plan during the 2000–2009 period.

The Workplace Environment

Starbucks' management believed that the company's competitive pay scales and comprehensive benefits for both full-time and part-time partners 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. After six months of employment, baristas could expect to earn $8.50 to $9.50 per hour. In 2009, experienced full-time baristas in the company's U.S. stores earned an average of about $37,800; store managers earned an average of $44,400.[30] Voluntary turnover at Starbucks was 13 percent in 2009.[31] Starbucks executives believed that efforts to make the company an attractive, caring place to work were responsible for its relatively low turnover rates. Starbucks received 225,000 job applications in 2008 and 150,000 job applications in 2009.

Surveys of Starbucks partners conducted by *Fortune* magazine in the course of selecting companies for inclusion on its annual list "100 Best Companies to Work For" indicated that full-time baristas liked working at Starbucks because of the camaraderie, while part-timers were particularly pleased with the health insurance benefits (those who enrolled in Starbucks' most economical plan for just routine health care paid only $6.25 per week).[32] Starbucks had been named to *Fortune*'s list in 1998, 1999, 2000, and every year from 2002 through 2010. In 2010, Starbucks was ranked 93rd, down from 24th in 2009 and 7th in 2008.

Starbucks' management used annual Partner View surveys to solicit feedback from its workforce, learn their concerns, and measure job satisfaction. The 2002 survey revealed that many employees viewed the benefits package as only "average," prompting the company to increase its match of 401(k) contributions for those who had been with the company more than three years and to have these contributions vest immediately. In a survey conducted in fiscal 2008, 80 percent of Starbucks partners reported being satisfied.[33]

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 efficiently. Schultz's rationale, based on his father's experience of going from one low-wage, no-benefits job to another, was that if you treated your employees well, they in turn would treat customers well.

Exhibit 7 contains a summary of Starbucks' fringe benefit program.

Employee Training and Recognition

To accommodate its strategy of rapid store expansion, Starbucks put in systems to recruit, hire,

Exhibit 7 Starbucks' Fringe Benefit Program, 2010

- Medical insurance
- Sick time
- Dental and vision care
- 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 nonretail hourly employees with five or more years of service)
- Six paid holidays
- One paid personal day every six months for salaried and nonretail hourly partners
- 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—the company matched from 25% to 150%, based on length of service, of each employee's contributions up to the first 4% of compensation
- Short- and long-term disability
- Stock purchase plan—eligible employees could buy shares at a discounted price through regular payroll deductions
- Life insurance
- Short- and long-term disability insurance
- Accidental death and dismemberment insurance
- Adoption assistance
- Financial assistance program for partners that experience a financial crisis
- Stock option plan (Bean stock)
- Pre-tax payroll deductions for commuter expenses
- Free coffee and tea products each week
- Tuition reimbursement program

Source: Starbucks, "Careers," www.starbucks.com, accessed June 7, 2010.

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."[34]

All partners/baristas hired for a retail job in a Starbucks store received at least 24 hours training in their first two to four weeks. The topics included classes on coffee history, drink preparation, coffee knowledge (four hours), customer service (four hours), and retail skills, plus a four-hour workshop called "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 customers, selling home espresso machines, 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 entitled them to a free drink.

Management trainees attended classes for 8 to 12 weeks. Their training went much deeper, covering not only coffee knowledge and information imparted to baristas but also details of store operations, practices and procedures as set forth in the company's operating manual, information systems, and the basics of managing people. Starbucks' trainers were all store managers and district managers with on-site experience. One of their major objectives was to ingrain the company's values, principles, and culture and to pass on their knowledge about coffee and their passion about Starbucks.

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 company's formal classes and basic orientation sessions at the Starbucks Coffee School in San Francisco. From time to time, Starbucks conducted special training programs, including a coffee masters program for store employees, leadership training for store managers, and career programs for partners in all types of jobs.

To recognize partner contributions, Starbucks had created a partner recognition program consisting of 18 different awards and programs. Examples included Coffee Master awards, Certified Barista awards, Spirit of Starbucks awards for exceptional achievement by a partner, a Manager of the Quarter for store manager leadership, Green Apron Awards for helping create a positive and welcoming store environment, Green Bean Awards for exceptional support for company's environmental mission, and Bravo! Awards for exceeding the standards of Starbucks customer service, significantly increasing sales, or reducing costs.

STARBUCKS' VALUES, BUSINESS PRINCIPLES, AND MISSION

During the early building years, Howard Schultz and other Starbucks senior executives worked to instill some key 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, saying that "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 would result in chemical residues being left behind to alter the flavor of beans ground afterward; plus, the chemical smell given off by artificially flavored beans was absorbed by other beans in the store.

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 straight with them, being 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 off-site 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 8. 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 8.

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. Sourcing from multiple geographic areas not only allowed Starbucks to offer a greater range of coffee varieties to customers but also spread the company's 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 were high enough to ensure that small farmers were able to cover their production costs and provide for their families.
- Use 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 protected biodiversity and were environmentally sustainable.

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 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 typically used fixed-price purchase commitments to limit its exposure to fluctuating coffee prices in upcoming periods and, on occasion, purchased coffee futures contracts to provide price protection. In years past, there had been times when unexpected jumps in coffee

Exhibit 8 Starbucks' Mission Statement, Values, 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 Forward

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: Starbucks, "Our Starbucks Mission," www.starbucks.com, accessed March 7, 2010.

prices had put a squeeze on Starbucks' margins, forcing an increase in the prices of the beverages and beans sold at retail. During fiscal 2008, Starbucks more than doubled its volume of its fixed-price purchase commitments compared with fiscal 2007 because of the risk of rising prices for green coffee beans. Starbucks bought 367 million pounds of green coffee beans in fiscal 2009, paying an average of $1.47 per pound. At the end of fiscal 2009, the company had purchase commitments totaling $238 million, which, together with existing inventory, were expected to provide an adequate supply of green coffee through fiscal 2010.[35]

Starbucks and Fair Trade Certified Coffee

A growing number of small coffee growers were members of democratically run cooperatives that were registered with the Fair Trade Labeling Organizations International; these growers could sell their beans directly to importers, roasters, and retailers at favorable guaranteed fair trade prices. The idea behind guaranteed prices for fair trade coffees was to boost earnings for small coffee growers enough to allow them to invest 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.

Starbucks began purchasing Fair Trade Certified coffee in 2000, steadily increasing its purchasing and marketing of such coffees in line with growing awareness of what Fair Trade Certified coffees were all about and consumer willingness to pay the typically higher prices for fair trade coffees. In 2008, Starbucks announced that it would double its purchases of Fair Trade Certified coffees in 2009, resulting in total purchases of 39 million pounds in 2009 (versus 19 million pounds in 2008 and 10 million pounds in 2005) and making Starbucks the largest purchaser of Fair Trade Certified coffee in the world. Starbucks marketed Fair Trade Certified coffees at most of its retail stores and through other locations that sold Starbucks coffees.

Best-Practice Coffee Cultivation and Environmental Sustainability

Since 1998, Starbucks had partnered with Conservation International's Center for Environmental Leadership to promote environmentally sustainable best practices in coffee cultivation methods and to develop specific guidelines—called Coffee and Farmer Equity (C.A.F.E.) Practices—to help farmers grow high-quality coffees in ways that were good for the planet. The C.A.F.E. Practices covered 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 environmental responsibility.[36] In addition, Starbucks operated Farmer Support Centers in Costa Rica and Rwanda that were staffed with agronomists and experts on environmentally responsible coffee growing methods; staff members at these two centers worked with coffee farming communities to promote best practices in coffee production and improve both coffee quality and production yields. During 2008–2009, approximately 80 percent of the coffee beans purchased by Starbucks came from suppliers whose coffee-growing methods met C.A.F.E. standards. In those instances where Starbucks sourced its coffee beans from non-grower C.A.F.E. Practices suppliers, it required suppliers to submit evidence of payments made through the coffee supply chain to demonstrate how much of the price Starbucks paid for green coffee beans got to the farmer/grower.

A growing percentage of the coffees that Starbucks purchased were grown organically (i.e., without the use of pesticides, herbicides, or chemical fertilizers); organic cultivation methods resulted in clean ground water and helped protect against degrading of local ecosystems, many of which were fragile or in areas where biodiversity was under severe threat. Starbucks purchased 14 million pounds of certified organic coffee in fiscal 2009.

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. Starbucks' standards were so exacting that roasters tested the color of the beans in a blood-cell analyzer and discarded the entire batch if the reading wasn't on target. 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.

Starbucks had roasting plants in Kent, Washington; York, Pennsylvania; Minden, Nevada; Charleston, South Carolina; and The Netherlands. In addition to roasting capability, these plants also had additional space for warehousing and shipping coffees. In keeping with Starbucks' corporate commitment to reduce its environmental footprint, the new state-of-the-art roasting plant in South Carolina had been awarded LEED Silver certification for New Construction by the U.S. Green Building Council. Twenty percent of materials used in the construction of the building were from recycled content and more than 75 percent of the waste generated during construction was recycled. In addition, the facility used state-of-the-art light and water fixtures and was partly powered by wind energy. Some of the green elements in the South Carolina plant were being implemented in the other roasting plants as part of the company's initiative to achieve LEED certification for all company-operated facilities by the end of 2010.[37] In May 2010, Starbucks announced the opening of its first LEED-certified store in Asia. Located in Fukuoka, Japan, the new store was designed to serve as an extension of the existing landscape and to preserve the surrounding trees.[38]

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 as a company since Howard Schultz first became CEO in 1987. 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 its business in ways that earned the trust and respect of customers, partners/employees, suppliers, and the general public.

The Starbucks Foundation was set up in 1997 to orchestrate the company's philanthropic activities. Starbucks stores participated regularly in local charitable projects and community improvement activities. For years, the company had engaged in efforts to reduce, reuse, and recycle waste, conserve on water and energy usage, and generate less solid waste. Customers who brought their own mugs to stores were given a $0.10 discount on beverage purchases—in 2009, some 26 million beverages were served in customers' mugs. Coffee grounds, which were a big portion of the waste stream in stores, were packaged and given to customers, parks, schools, and plant nurseries as a soil amendment. Company personnel purchased paper products with high levels of recycled content and unbleached fiber. 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. Suppliers were encouraged to provide the most energy-efficient products within their category and eliminate excessive packaging; Starbucks had recently instituted a set of Supplier Social Responsibility Standards covering the suppliers of all the manufactured goods and services used in the company's operations. No genetically modified ingredients were used in any food or beverage products that Starbucks served, with the exception of milk (U.S. labeling requirements do not require milk producers to disclose the use of hormones aimed at increasing the milk production of dairy herds). In 2005, Starbucks made a $5 million, five-year commitment to long-term relief and recovery efforts for victims of hurricanes Rita and Katrina and committed $5 million to support educational programs in China. In 2010, the Starbucks Foundation donated $1 million to the American Red Cross efforts to provide aid to those suffering the devastating effects of the earthquake in Haiti; in addition, Starbucks customers were invited to make cash donations to the Haitian relief effort at store registers.[39]

In 2008–2010, Starbucks' corporate social responsibility strategy had four main elements:

1. *Ethically sourcing all of the company's products.* This included promoting responsible growing practices for the company's coffees, teas, and cocoa and striving to buy the manufactured products and services it needed from suppliers that had a demonstrated commitment to social and environmental responsibility. Starbucks had a 2015 goal of purchasing 100 percent of its coffees through sources there were either Fair Trade Certified or met C.A.F.E. Practices guidelines.
2. *Community involvement.* This included engaging in a wide variety of community service activities, Starbucks Youth Action Grants to engage young people in community improvement projects (in fiscal 2009, Starbucks made 71 grants totaling $2.1 million), a program to provide medicine to people in Africa with HIV, the Ethos Water Fund, and donations by the Starbucks Foundation. The company had a goal of getting Starbucks partners and customers to contribute more than 1 million hours of community service annually by 2015; service contributions totaled 246,000 hours in 2008 and 186,000 hours in 2009.
3. *Environmental stewardship.* Initiatives here included a wide variety of actions to increase recycling, reduce waste, be more energy-efficient and 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. The company had immediate objectives of achieving LEED certification globally for all new company-operated stores beginning in late 2010, reducing energy consumption in company-owned stores by 25 percent by the end of fiscal 2010, and purchasing renewable energy equivalent to 50 percent of the electricity used in company-owned stores by the end of fiscal 2010. Management believed that the company was on track to achieve all three targets.

   In 2009, Starbucks became a member of the Business for Innovative Climate Change and Energy Policy coalition, which sought to spur a clean energy economy and mitigate global warming by advocating strong legislation by the U.S. Congress. Starbucks was also collaborating with Earthwatch Institute on replanting rain forests, mapping water resources and biodiversity indicators, and sharing sustainable agriculture practices with coffee growers. Starbucks had goals to implement front-of-store recycling in all company-owned stores by 2015, to ensure that 100 percent of its cups were reusable or recyclable by 2015, to serve 25 percent of the beverages made in its stores in reusable containers by 2015, and to reduce water consumption in company-owned stores by 25 percent by 2015. In 2009 the company made progress toward achieving all these goals but still faced significant challenges in implementing recycling at its more than 16,000 stores worldwide because of wide variations in municipal recycling capabilities.
4. *Farmer loans.* Because many of the tens of thousands of small family farms with less than 30 acres 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 to organizations that made loans to small coffee growers. Over the years, Starbucks had committed more than $15 million to a variety of coffee farmer loan funds. The company boosted its farmer loan commitments from $12.5 million to $14.5 million in 2009 and had a goal to commit a total of $20 million by 2015.

In 2010, Starbucks was named to *Corporate Responsibility Magazine*'s list "The 100 Best Corporate Citizens" for the 10th time. The "100 Best Corporate Citizens" 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. In addition, Starbucks had received over 25 awards from a diverse group of organizations for its philanthropic, community service, and environmental activities.

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 customer traffic in Starbucks' U.S. stores began to erode in 2007, new store openings worldwide were continuing at the rate of six per day, and Donald kept pressing for increased efficiency in store operations at the expense of good customer service. Investors were distressed with the company's steadily declining stock price during 2007. Schultz had lamented in a 2007 internal company e-mail (which was leaked to the public) that the company's aggressive growth had led to "a watering down of the Starbucks experience."[40] In January 2008, Starbucks' board asked Howard Schultz to return to his role as CEO and lead a major restructuring and revitalization initiative.

HOWARD SCHULTZ'S TRANSFORMATION AGENDA FOR STARBUCKS, 2008–2010

Immediately upon his return as Starbucks CEO, Schultz undertook a series of moves to revamp the company's executive leadership team and change the roles and responsibilities of several key executives.[41] A former Starbucks executive was hired for the newly created role of chief creative officer responsible for elevating the in-store experience of customers and achieving new levels of innovation and differentiation.

Because he believed that Starbucks in recent years had become less passionate about customer relationships and the coffee experience that had fueled the company's success, Schultz further decided to launch a major campaign to retransform Starbucks into the company he had envisioned it ought to be and to push the company to new plateaus of differentiation and innovation—the transformation effort instantly became the centerpiece of his return as company CEO. Schultz's transformation agenda for Starbucks had three main themes: strengthen the core, elevate the experience, and invest and grow. Specific near-term actions that Schultz implemented to drive his transformation of Starbucks in 2008–2010 included the following:

- Slowing the pace of new store openings in the United States and opening a net of 75 new stores internationally.
- Closing 900 underperforming company-operated stores in the United States, nearly 75 percent of which were within three miles of an existing Starbucks store. It was expected that these closings would boost sales and traffic at many nearby stores.
- Raising the projected return on capital requirements for proposed new store locations.
- Restructuring the company's store operations in Australia to focus on three key cities and surrounding areas—Brisbane, Melbourne, and Sydney—and to close 61 underperforming store locations (mostly located in other parts of Australia).
- Coming up with new designs for future Starbucks stores. The global store design strategy was aimed at promoting a reinvigorated customer experience by reflecting the character of each store's surrounding neighborhood and making customers feel truly at home when visiting their local store. All of the designs had to incorporate environmentally friendly materials and furnishings.
- Enhancing the customer experience at Starbucks stores, including the discontinuance of serving warmed breakfast sandwiches in North American stores (because the scent of

warmed sandwiches interfered with the coffee aroma) and a program to develop best-in-class baked goods and other new menu items that would make Starbucks a good source of a healthy breakfast for people on the go and better complement its coffee and espresso beverages. These efforts to improve the menu offerings at Starbucks stores were directly responsible for (1) the recent additions of fruit cups, yogurt parfaits, skinny lattes, the farmer's market salad, Vivanno smoothies, and healthier bakery selections, (2) the reformulated recipes to cut back on or eliminate the use of artificial flavorings, dyes, high-fructose corn syrup, and artificial preservatives, and (3) all-day brewing of Pikes Place Roast.

- A program to share best practices across all stores worldwide.
- Additional resources and tools for store employees, including laptops, an Internet-based software for scheduling work hours for store employees, and a new point-of-sale system for all stores in the United States, Canada, and the United Kingdom.
- Rigorous cost-containment initiatives to improve the company's bottom line, including a 1,000-person reduction in the staffing of the company's organizational support infrastructure to trim administrative expenses at the company's headquarters and regional offices.
- Renewed attention to employee training and reigniting enthusiasm on the part of store employees to please customers. In February 2008, Schultz ordered that 7,100 U.S. stores be temporarily closed for three regularly operating business hours (at 5:30 p.m. local time) for the purpose of conducting a special training session for store employees. The objectives were to give baristas hands-on training to improve the quality of the drinks they made, help reignite the emotional attachment of store employees to customers (a long-standing tradition at Starbucks stores), and refocus the attention of store employees on pleasing customers. Schultz viewed the training session as a way to help the company regain its "soul of the past" and improve the in-store Starbucks experience for customers.[42] When several major shareholders called Schultz to get his take on why he was closing 7,100 stores for three hours, he told them, "I am doing the right thing. We are retraining our people because we have forgotten what we stand for, and that is the pursuit of an unequivocal, absolute commitment to quality."[43]

Schultz's insistence on more innovation had also spurred the recent introduction of the Starbucks VIA instant coffees.

Howard Schultz believed that the turning point in his effort to transform Starbucks came when he decided to hold a leadership conference for 10,000 store managers in New Orleans in early 2008. According to Schultz:

> I knew that if I could remind people of our character and values, we could make a difference. The conference was about galvanizing the entire leadership of the company—being vulnerable and transparent with our employees about how desperate the situation was, and how we had to understand that everyone must be personally accountable and responsible for every single customer interaction. We started the conference with community service. Our efforts represent the largest single block of community support in the history of New Orleans, contributing more than 54,000 volunteer hours and investing more than $1 million in local projects like painting, landscaping, and building playgrounds.
>
> If we had not had New Orleans, we wouldn't have turned things around. It was real, it was truthful, and it was about leadership. An outside CEO would have come into Starbucks and invariably done what was expected, which was cut the thing to the bone. We didn't do that. Now we did cut $581 million of costs out of the company. The cuts targeted all areas of the business, from supply chain efficiencies to waste reduction to rightsizing our support structure. But 99 percent were not consumer-facing, and in fact, our customer satisfaction scores began to rise at this time and have continued to reach unprecedented levels. We reinvested in our people, we reinvested in innovation, and we reinvested in the values of the company.

In 2010, as part of Schultz's "invest and grow" aspect of transforming Starbucks, the company was formulating plans to open "thousands of new stores" in China over time.[44] 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."[45]

Schultz also indicated that Starbucks was anxious to begin opening stores in India and Vietnam, two country markets that Starbucks believed were potentially lucrative.

Exhibit 9 is a letter that Howard Schultz sent to customers on the day he reassumed the position of Starbucks' chief executive officer. Exhibit 10 is a letter that Howard Schultz sent to all Starbucks partners three weeks after he returned as company CEO.

STARBUCKS' FUTURE PROSPECTS

In April 2010, halfway through the fiscal year, Howard Schultz continued to be pleased with the company's progress in returning to a path of profitable, long-term growth. Following five consecutive quarters of declining sales at stores open 13 months or longer (beginning with the first quarter of fiscal 2008), sales at Starbucks' company-operated stores worldwide had improved in each of the most recent five consecutive quarters—see Exhibit 11. Moreover, traffic (as measured by the number of cash register transactions) increased by 3 percent in the company's U.S. stores in the second quarter of fiscal 2010, the first positive increase in the last 13 quarters. Net revenues increased 8.6 percent in the second quarter of fiscal 2010 compared with the same quarter in fiscal 2009, while net income jumped from $25.0 million in the second quarter of fiscal 2009 to $217.3 million in the second quarter of fiscal 2010.

Exhibit 9 Letter from Howard Schultz to Starbucks Customers, January 7, 2008

To Our Customers:

Twenty-five years ago, I walked into Starbucks' first store and I fell in love with the coffee I tasted, with the passion of the people working there, and with how it looked, smelled and felt. From that day, I had a vision that a store can offer a welcoming experience for customers, be part of their community, and become a warm "third place" that is part of their lives everyday and that it can provide a truly superior cup of coffee.

Based on that vision, I, along with a very talented group of people, brought Starbucks to life. We did it by being creative, innovative and courageous in offering coffee products that very few in America had ever tasted; by celebrating the interaction between us and our customers; by developing a store design unlike any that existed before; and by bringing on board an exceptionally engaged group of partners (employees) who shared our excitement about building a different kind of company.

In doing this, we developed a culture based on treating each other, our customers and our coffee growers with respect and dignity. This includes embracing diversity, committing ourselves to ethical sourcing practices, providing health care and stock options to all of our eligible full- and part-time partners, supporting the communities we serve, and, most of all, ensuring that we are a company you can be proud to support.

I am writing today to thank you for the trust you have placed in us and to share with you my personal commitment to ensuring that every time you visit our stores you get the distinctive Starbucks Experience that you have come to expect, marked by the consistent delivery of the finest coffee in the world. To ensure this happens, in addition to my role as chairman, I am returning to the position of chief executive officer to help our partners build upon our heritage and our special relationship with you, and lead our company into the future.

We have enormous opportunity and exciting plans in place to make the Starbucks Experience as good as it has ever been and even better. In the coming months, you will see this come to life in the way our stores look, in the way our people serve you, in the new beverages and products we will offer. That is my promise to you. Everyone at Starbucks looks forward to sharing these initiatives with you.

Onward,

Howard Schultz

Source: Starbucks, press release, January 7, 2008, www.starbucks.com, accessed June 17, 2010.

Exhibit 10 Communication from Howard Schultz to All Starbucks Partners, February 4, 2008

What I Know to Be True

Dear Partners,

As I sit down to write this note (6:30 a.m. Sunday morning) I am enjoying a spectacular cup of Sumatra, brewed my favorite way—in a French press.

It has been three weeks since I returned to my role as CEO of the company I love. We have made much progress as we begin to transform and innovate and there is much more to come. But this is not a sprint—it is a marathon—it always has been. I assure you that when all is said and done, we will, as we always have, succeed at our highest potential. We will not be deterred from our course—we are and will be a great, enduring company, known for inspiring and nurturing the human spirit.

During this time, I have heard from so many of you; in fact, I have received more than 2,000 emails. I can feel your passion and commitment to the company, to our customers and to one another. I also thank you for all your ideas and suggestions . . . keep them coming. No one knows our business and our customers better than you. I have visited with you in many of your stores, as well as stopping by to see what our competitors are doing as well.

It's been just a few days since my last communications to you, but I wanted to share with you

what I know to be true:

- Since 1971, we have been ethically sourcing and roasting the highest quality *Arabica* coffee in the world, and today there is not a coffee company on earth providing higher quality coffee to their customers than we are. Period!
- We are in the people business and always have been. What does that mean? It means you make the difference. You are the Starbucks brand. We succeed in the marketplace and distinguish ourselves by each and every partner embracing the values, guiding principles and culture of our company and bringing it to life one customer at a time.

  Our stores have become the Third Place in our communities—a destination where human connections happen tens of thousands of times a day. We are not in the coffee business serving people. We are in the people business serving coffee. You are the best people serving the best coffee and I am proud to be your partner. There is no other place I would rather be than with you right here, right now!
- We have a renewed clarity of purpose and we are laser-focused on the customer experience. We have returned to our core to reaffirm our coffee authority and we will have some fun doing it. We are not going to embrace the status quo. Instead, we will be curious, bold and innovative in our actions and, in doing so, we will exceed the expectation of our customers.
- There will be cynics and critics along the way, all of whom will have an opinion and a point of view. This is not about them or our competitors, although we must humbly respect the changing landscape and the many choices facing every consumer. We will be steadfast in our approach and in our commitment to the *Starbucks Experience*—what we know to be true. However, this is about us and our customers. We are in control of our destiny. Trust the coffee and trust one another.
- I will lead us back to the place where we belong, but I need your help and support every step of the way. My expectations of you are high, but higher of myself.
- I want to hear from you. I want to hear about your ideas, your wins, your concerns, and how we can collectively continue to improve. Please feel free to reach out to me. I have been flooded with emails, but believe me, I am reading and responding to all of them.

As I said, I am proud to be your partner. I know this to be true.

Onward . . .

Howard

P.S. Everything that we do, from this point on (from the most simple and basic), matters.

Master the fundamentals. Experience Starbucks.

Source: Starbucks, press release, February 4, 2008, www.starbucks.com, accessed June 17, 2010.

Exhibit 11 Quarterly Sales Trends at Starbucks Company-Operated Stores, Quarter 1 of Fiscal 2008 through Quarter 2 of Fiscal 2010

	Five Quarters of Deteriorating Sales				
Sales at Company-Operated Starbucks Stores	**Q1 2008**	**Q2 2008**	**Q3 2008**	**Q4 2008**	**Q1 2009**
United States	(1%)	(4%)	(5%)	(8%)	(10%)
International	5%	3%	2%	0%	(3%)
	Five Quarters of Improving Sales				
Sales at Company-Operated Starbucks Stores	**Q2 2009**	**Q3 2009**	**Q4 2009**	**Q1 2010**	**Q2 2010**
United States	(8%)	(6%)	(1%)	4%	7%
International	(3%)	(2%)	0%	4%	7%

In commenting on the company's earnings for the second quarter of fiscal 2010, Schultz said:

> Starbucks second quarter results demonstrate the impact of innovation and the success of our efforts to dramatically transform our business over the last two years. Much credit goes to our partners all around the world who continue to deliver an improved experience to our customers. In addition, new products like Starbucks VIA, the opening of exciting new stores in Asia, Europe and the U.S., and expanded distribution outside our retail stores all represent opportunities for future growth.[46]

In March 2010, Starbucks announced its first-ever cash dividend of $0.10 per share to be paid quarterly starting with the second quarter of fiscal 2010.

The company's updated targets for full-year 2010 were as follows:

- Mid-single-digit revenue growth worldwide, driven by mid-single-digit sales growth at company-operated stores open at least 13 months.
- Opening approximately 100 net new stores in the United States and approximately 200 net new stores in international markets. Both the U.S. and international net new additions were expected to be primarily licensed stores.
- Earnings per share in the range of $1.19 to $1.22.
- Non-GAAP earnings per share in the range of $1.19 to $1.22, excluding approximately $0.03 of expected restructuring charges and including approximately $0.04 from the extra week in the fiscal fourth quarter, as fiscal 2010 was a 53-week year for Starbucks.
- Capital expenditures are expected to be approximately $500 million for the full year.
- Cash flow from operations of at least $1.5 billion, and free cash flow of more than $1 billion.

Long term, the company's objective was to maintain Starbucks' standing as one of the most recognized and respected brands in the world. To achieve this, Starbucks executives planned to continue disciplined global expansion of its company-operated and licensed retail store base, introduce relevant new products in all its channels, and selectively develop new channels of distribution.

Schultz's long-term vision for Starbucks had seven key elements:

- Be the undisputed coffee authority.
- Engage and inspire Starbucks partners.
- Ignite the emotional attachment with our customers.
- Expand our global presence—while making each store the heart of the local neighborhood.
- Be a leader in ethical sourcing and environmental impact.
- Create innovative growth platforms worthy of our coffee.
- Deliver a sustainable economic model.

Schultz believed that Starbucks still had enormous growth potential. In the United States, Starbucks had only a 3 percent share of the estimated

37 billion cups of coffee served to on-the-go coffee drinkers, only a 4 percent share of the 25 billion cups of coffee served at home, and only a 13 percent share of the 3.7 billion cups of coffee served in restaurants and coffeehouses.[47] Internationally, Starbucks' shares of these same segments were smaller. According to Schultz:

> The size of the prize is still huge. We sell less than 10 percent of the coffee consumed in the U.S. and less than 1 percent outside the U.S. The momentum will come from international. Slower growth in the U.S., accelerating growth overseas. The response to the Starbucks brand has been phenomenal in our international markets.[48]

Nonetheless, since his return as CEO in January 2008, Schultz had been mum about whether and when the company would aggressively pursue former CEO Jim Donald's lofty goal of having 40,000 stores worldwide.

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