

MGMT 3400 – Organizational Behavior

THE SUCCESS OF STARBUCKS

The first time Howard Schultz walked into a Starbucks Coffee Company store, he fell in love. In 1981, Schultz was in the Seattle store to sell drip coffeemakers. Starbucks was a local three-store chain that sold coffee beans and accessories, but the owners put great care into choosing and roasting the beans and they taught their customers that same appreciation.

Schultz said to himself, “What a great company, what a great city. I’d love to be part of that.” He spent a year convincing the owners to hire him as director of marketing... “I was this East Coast person and I had so much drive and energy, I think I might have scared them at first,” Schultz admits. He acknowledges that perseverance is one of the most important traits of a successful entrepreneur, adding, “I have a history of people closing doors on me saying, “No, it’s still open.”

One year later, Schultz was struck by another lightning bolt. After a visit to Italy, he realized that coffee bars there provided a location for socializing and relaxing. Schultz believed that the social aspect would appeal to Americans, fulfilling a need that restaurants and shopping malls failed to address. Back home, Starbucks’s owners refused to enter the highly competitive restaurant business. Schultz quit. He founded a successful coffee bar business and eighteen months later, used the profits to buy Starbucks for \$3.8 million.

From that uncertain beginning, Starbucks grew into a retailing powerhouse, with more than 8,000 locations, 97,000 employees, and annual sales of \$5.3 billion. Starbucks appears on the *Fortune 500* list and dominates the specialty eateries industry. Dunkin’ Donuts, its closest competitor, is part of the gigantic conglomerate Pernod Ricard, but has less than one-tenth the sales of Starbucks. Other popular specialty food shops, such as Cold Stone Creamery and Jamba Juice, are much smaller, boasting annual sales from \$150 to \$300 million.

Starbucks has grown rapidly without franchising, although it offers licenses in a few locations. Schultz avoids franchising because he believes that quality and image control are vital to success. Starbucks funds growth with current earnings and has locations in thirty-four countries. Sales revenues increase by double digits in many years. Constant innovation is another indicator of the company’s effectiveness.

Starbucks has satisfied many stakeholders, including investor, customers, and employees. Stock price has risen from around \$25 in mid-2003 to over \$50 in mid-2005, signaling that investors are confident. The total market capitalization was \$200 million in 1992, when the firm had its initial public offering. Today it’s worth \$19 billion. The company never advertises nationally. Starbucks’s phenomenal sales growth springs from word-of-mouth from satisfied customers. And there are lots of customers – about 30 million weekly. In 2004, Starbucks was named, for the sixth time, to the *Fortune* Best Companies to Work for list. The company was ranked 34th, up from 47th in 2003.

What created this success? One of the most important factors is the management skill and ability of Howard Schultz and the subsequent CEOs, Orin Smith and Jim Donald. Schultz was raised in a Brooklyn housing project, the son of a working-class family. Schultz says about that time, “I saw the fracturing of the American dream...My parents didn’t have much – and they didn’t have much hope.” After attending college on a scholarship, Schultz held positions in sales and operations for various firms, ending up as a manager of U.S. operations for Hammarplast. By 1985, he owned Starbucks, which went public in 1992. In 2000, Schultz stepped down from the CEO position, although he remains a member of the board of directors. Although he no longer has daily management responsibility, it is his vision that guides Starbucks today.

Orin C. Smith headed the firm from 2000 to 2005, after joining Starbucks in 1990. Smith’s background was quite different from Schultz’s. Smith has an MBA from Harvard, worked for years at management consulting firm Deloitte & Touche, and served as a top manager in several large firms before joining Starbucks. Smith was an effective manager who turned Schultz’s visions into reality. He oversaw a time of rapid growth, innovation, and operational improvements.

In 2005, Starbucks gained its third CEO, Jim Donald. Donald worked as a bag boy in a supermarket during high school; by nineteen he was an assistant manager, making more money than his schoolteacher father. Donald is down-to-earth and folksy, knows everyone’s name, and is willing to lend a hand. When Donald was giving a store tour, a customer spilled coffee. Donald grabbed a mop and cleaned the floor himself. “Being a grocery guy means you always know where the clean supplies are,” he says. Before Starbucks, Donald helped Wal-Mart introduce groceries into their stores in the early 1990s, then aided Pathmark, an ailing grocery chain, in its recovery from bankruptcy.

However, no matter how skilled the managers, a company’s success also relies on a number of factors from the business environment. Starbucks appeals to a demographic market segment who needs have been ignored by the food-service industry. The typical Starbucks customer is affluent, well-educated, and thirty to fifty years old. Traditional fast-food outlets do not appeal to this segment. Above all else, these customers want customization-products that are personalized to their tastes and needs. Anne Saunders, senior vice president of marketing, worked in a Starbucks store when she was first hired, as does every executive. “I waited on hundreds of customers while working the cash registers and was struck by how every single one of them ordered something different,” Saunders says. “Every single person coming in here has a different experience, designed to the way they want it.”

The preference for the personalization is so well known that the popular movie *You’ve Got Mail* gently makes fun of the phenomenon. In the film, Joe (played by Tom Hanks) writes in an email, “The whole purpose of places like Starbucks is for people with no decision-making ability whatsoever to make six decisions just to buy one cup of coffee. People can get...an absolutely defining sense of self.”

Another opportunity presented by Starbucks’s environment is the potential for global expansion. Starbucks has entered thirty-three European, Asian, and Middle Eastern countries, but there are still markets the company could enter. In addition, the number of outlets in each country could

be expanded. Starbucks plans to build 15,000 more overseas locations over five years, about half of the expected new stores.

Expansion plans are not stopped by the fear that selling American-style coffee and fast service to European customers, who are used to a more relaxed environment, might be tough. Plans continue in spite of anti-American sentiment that has been fueled by the war in Iraq. Some brands that are highly identified with the United States (Barbie dolls and AOL, for example) have seen their foreign sales fall in recent months.

Starbucks's operations become profitable only when there are a sufficient number of locations in a region or a country to gain economies of scale. It takes time for customers to become familiar with the company's products. Also, expenses are higher in Europe. Minimum wage in France, for instance, is \$9.92 hourly, almost double the U.S. rate of \$5.15. For these reasons, international operations produced adequate revenues but did not become profitable for Starbucks until 2004. Schultz explains the slow start, saying, "We're simply maturing. Not that we're getting close to maturity, because we're just scratching the surface internationally, but the markets are getting larger now.

The environment also presents some threats to Starbucks. Rising costs are a problem. The cost for employee healthcare benefits in the United States is sharply increasing. Schultz remains absolutely committed to providing health insurance for every employee who works twenty hours or more. This is a rarity in the restaurant industry, but Schultz believes that it's vital for his company to provide a living wage. Although hourly wages for overseas employees are higher, national health insurance in many countries allows Starbucks to save money on benefits.

Starbucks has been targeted by some advocate groups that are critical of the company's policies. While some of the coffee Starbucks sells is organic and shade grown, environmentalists want them to sell more. They also want Starbucks to sell more Fair Trade certified coffee, which guarantees a living wage and safe working conditions for coffee farm workers. Consumer food safety advocates want Starbucks to stop selling milk that contains hormones and other ingredients that are genetically modified. The company claims that it is environmentally friendly as is possible. For example, the company buys 200 million pounds of coffee each year, far more than the current worldwide supply of Fair Trade or organic coffee. Starbucks has developed Coffee and Farmer Equity (CAFÉ), a set of guidelines that includes some of the Fair Trade coffee requirements. The CAFÉ standards have been adopted by other firms and Starbucks has won awards for its environmentally friendly supplier guidelines.

Even Starbucks's very apparent success opens the company up to criticism. Writer Ruth Rosselson suggests "consumers choose non-chain shops that offer fair-trade coffee. Starbucks...puts local companies out of business and with this policy can never be 100 percent ethical." Many agree. On the other hand, studies have shown that when Starbucks enters a city for the first time, coffee consumption increases and local coffee houses experience increased sales. Some local coffee bar chains take advantage of this trend by opening a new store on the same block whenever Starbucks opens one.

For now, Starbucks's continued success seems assured, although skeptics claim there is a limit to the number of \$4 cups of coffee people will buy. Among them is venture capitalist and author Geoffrey Moore. "Of course, no chief executive wants to say, "Yes, our market is saturated." The notion that 7% market share means he still has a big field to go after is silly," Moore asserts. "His market is people who buy into an upscale 21st-century café society experience, which is much smaller."

Yet Moore and other doubters have consistently been proven wrong. Analyst Sandy Sanders believes that customers will continue to indulge. "It's a simple way of rewarding yourself without spending a ton of money," Sanders claims. Schultz is optimistic about the future of Starbucks. "We are in the infant stages of the growth of the business in America," he says. "And now seeing what we've done internationally...we are going to shock people in terms of what Starbucks is going to be."

STARBUCKS AND ITS EMPLOYEES

Starbucks sells food and drinks, but the most important component of a customer's purchase is the service. Customers demand high-quality service that is personal, friendly, fast, and accurate. They want a relaxing and social store atmosphere. Customer satisfaction is crucial to generating profitable repeat buyers, as the most loyal customers visit Starbucks eighteen times a month or more. "When...the person behind the counter says hello and maybe greets you by name, you feel a connection you don't find with most retailers anymore. It makes you feel welcome and it makes you want to come back," says Dave Pace, executive vice president. To offer that level of service and atmosphere, Starbucks depends on its 97,000 worldwide employees.

Success starts with choosing workers, called "baristas" (from the Italian word for barkeeper), for front-line positions. A good person-job fit is created by selecting individuals with the right skills and personality. Baristas must be knowledgeable about the various items that Starbucks sells. They are constantly on their feet, must lift heavy items frequently, use dangerously hot machinery, and communicate and cooperate with their coworkers. Most importantly, they must provide a satisfying, personal interaction to hundreds of customers each day. "Our baristas are the foundation of our business," claims the company. "Baristas deliver legendary customer service to all customers by acting with a "customer comes first" attitude and connecting with the customer. They discover and respond to customer needs," To meet high customer expectations, Starbucks "looks for people who are adaptable, self-motivated, passionate, creative team players."

It's not hard to find individuals with the minimal skills needed for entry-level jobs. However, it's more difficult to identify who can contribute the most and who is most likely to stay. Applicants undergo interviews with two managers, to assess complex abilities such as social and communication skills. Each applicant completes a behavior assessment designed to measure cooperativeness, extroversion, honesty, and conscientiousness.

"It's not hard to recruit at this company", claims vice president Sheri Southern. "People want to work here. We're very fortunate that way." The company has a reputation for being a great

employer. A 2004 survey found that 82 percent of employees were satisfied or very satisfied. In January 2005, Starbucks was named #2 on *Fortune* magazine's list of best large employers. One tangible measure of the good person-job fit at Starbucks is the low annual turnover rate among baristas – 80 percent – compared to 200 percent for the quick-serve food industry. Starbucks CEO Jim Donald is intensely interested in generating enough applicants to keep up with growth while maintaining the quality of personnel. The company must hire 200 new workers each day, for vacancies at existing stores and for new locations. "My biggest fear isn't the competition, although I respect it," Donald says. "It's having a robust pipeline of people to open and manage the stores who will also be able to take their next steps with the company."

Although Starbucks baristas are generally satisfied, their jobs can be stressful. There are the physical demands of constant standing and walking. At the same time, baristas must properly prepare orders and work in a constrained physical space with others. Interpersonal stress can also be high. It is difficult to establish a personal and positive relationship with a stranger in just a few seconds, and baristas must do this over and over again for hours. As in any job with heavy customer contact, there is the potential for unpleasant interactions and encounters with difficult customers. For example, some of Starbucks's customers are irritated by the language the company uses. Although customers may order Starbucks's products by using the words "small, medium, large," the baristas are required by the company to respond with the official terms of "tall, grande, venti." "Customer will mock the drink sizes and get snippy with the barista over how they think it's stupid to note just use small, medium and large. And that's when I find myself tempted to be rude. To simply say, "Oh, thank you, mister! I'm so glad you're taking on the corporate dominance of Starbucks by irritating an hourly employee!" says one barista.

Another factor in creating success through the efforts of individuals is to properly design the work. The job of barista combines physical production, personal interaction, and planning and time management. Therefore, workers use a variety of skills and switch tasks frequently, reducing boredom and fatigue. The barista participates in the entire process, from the time the customer enters the store through payment. Baristas receive constant feedback from customers about their performance. Based on Hackman and Oldham's job characteristics theory, these qualities of the barista job should result in higher satisfaction and motivation. On the other hand, baristas do not have a lot of autonomy. The products must be prepared consistently, reducing creative opportunities. Also, although providing good customer service is a priority, baristas may feel that their job does not have a significant impact on others. These factors would tend to reduce satisfaction and motivation.

Another important aspect of job design at Starbucks is work scheduling. About two-thirds of Starbucks's 76,000 U.S. workers have part-time work schedules. Of those, about one-half work twenty hours or more each week. Operating hours for each Starbucks location is determined by local demand; however, many stores open as early as 6:00 A.M. and remain open until 11:00 P.M. The busiest hours at most stores are between 8:00 A.M. and 10:00 A.M. Clearly then, work scheduling is a complex task. Stores use a flexible scheduling approach. Many baristas appreciate the part-time and flexible nature of their work hours, so they may attend school or meet other needs. Some workers, however, would prefer a more predictable schedule. In addition, the total number of hours worked per week has a significant impact on income and benefits eligibility, so some workers are displeased when their hours vary.

From 2000 to 2005, then CEO Orin Smith concentrated on improving operational effectiveness. Automated espresso machines were introduced to speed up coffee production, which now takes about one minute per cup, down from three minutes. The taste of the machine-made drinks is as good as those made by hand, an important point for quality-conscious Starbucks. Another factor in the decision to adopt espresso machines was worker safety. Overall, Starbucks is a very safe employer. Workers sustain injuries at about half the rate of other companies in the industry. However, burns are the most frequent injuries sustained by baristas and are a concern. Automated machines reduce baristas' burn rate by 50 percent. Workers must learn new skills in order to operate the new machinery.

Finally, success based on individual employees comes from motivating workers to perform at high levels, coupled with meaningful and appropriate rewards. CEO Donald role-models motivation skills. Every morning, he calls five store managers for a personal chat. Then he calls three hourly workers. Donald says, "We've got to be able to reach into this organization and say, 'How's it going?'" and "Good job!" If any company doesn't have the time to talk to people on the front lines, then you might as well close it up, because it's not going anywhere."

Motivation at Starbucks is accomplished through the use of rewards to meet the needs of employees. An important motivator is base pay, which at Starbucks is about average for the fast-food industry. The average annual pay for full-time hourly employees, including baristas and shift supervisors, is \$35,294. However, Starbucks also offers above-average benefits to most workers. Bonuses are a rare benefit in the fast-food industry. In 2004, Starbucks paid each hourly worker a \$250 annual cash bonus.

Starbucks also offers a level of healthcare benefits that is unusual, especially for part-time workers. All employees who work half-time or more can receive healthcare benefits, including medical, drug, vision, dental, and even alternative medicine. In its list of the Best Companies to Work For published in January of 2005, *Fortune* magazine said about Starbucks: "The coffee behemoth is justly famous for its generous benefits. One example: Part-timers and their same-sex or opposite-sex partners receive comprehensive health coverage. Hypnotherapy? Covered. Naturopathy? Ditto." The company pays between 50 percent and 80 percent of the cost of the care for workers and family members.

A stock purchase plan allows employees to buy shares of Starbucks at a 15 percent discount. Another program, called "Bean Stock," grants stock options to almost every employee, allowing them to purchase stock at even deeper discounts. The stock options are awarded based on an individual's pay, length of employment, and even more importantly, Starbucks's overall corporate performance. Stock ownership is seen as a way to increase wealth for hourly workers, while also helping to align their interests with those of the company. "Share success with people who make it happen," says vice president Emily Ericsen. "It makes everybody think like an owner, which helps them build long-term relationships with customers and influences them to do things in an efficient way."

Starbucks also offers a variety of miscellaneous benefits, including reimbursement for college tuition and adoption expenses. All employees get free beverages and on pound of free coffee

beans. Time-off benefits include paid vacation for full-time employees, and personal days and time-and-a-half pay for holiday work. Extensive training improves employee's skills and prepares them for positions of greater responsibility. Finally, the benefits package is flexible. Under the Starbucks's program, called "Your Special Blend," employees can shift benefits dollars between the various components of the total pay package, customizing their compensation. Each worker can use their benefit dollars in the way that provides the best value.

With its emphasis on appropriate recruiting, job design, and motivation, Starbucks is fulfilling its mission statement, which states, "[We will] provide a great work environment and treat each other with respect and dignity." Many employees realize that Starbucks, while not perfect, is clearly one of the best employers. When a barista posted negative comments on the Internet, one employee replied with: "Starbucks work isn't much different from that of any other foodservice job. Yet employees show more loyalty and support for Starbucks than they do for any other similar employer." Another also defended the firm, writing, "Starbucks does more for its employees than any other food service or retail business. Perhaps not as good as a company where everyone has their Masters degrees, but it's a lot better than the McDonald's and Wal-Mart's of the world."

INTEGRATIVE CASE QUESTIONS:

1. What are the organizational-level outcomes experienced by Starbucks Corporation? Based on these outcomes, do you think Starbucks is an effective organization? Why or why not?
2. What forces from the environment are affecting Starbucks? Does the environment present more opportunities or more threats for Starbucks? Explain.
3. Describe the psychological contract for baristas working at Starbucks. What are the inducements? What are the contributions? In your opinion, is this a reasonable and fair exchange? If so, explain why. If not, tell how it could be improved.
4. How do alternative work arrangements contribute to the motivation of baristas at Starbucks? Are there any potential limitations or drawbacks of the alternative work arrangements?
5. Consider all of the significant stakeholders of Starbucks: investors, employees, customers, and local communities. Do the generous rewards offered to baristas help or hinder each of these groups in reaching their goals? Explain.