Case 2 Starbucks Corporation, April 2012

If the rise of Starbucks from a single Seattle coffee store to the world's biggest supplier of coffee drinks is now part of the mythology of American entrepreneurial capitalism, the story of its guiding genius, Howard Schultz, fits a much older folklore, that of "the hero's return." After lifting Starbucks from obscurity to become one of the world's most successful service corporations, Schultz stepped down from the CEO position in 2000. By 2007, Starbucks' performance was flagging: margins and same-store sales were both in decline. Amidst fears of market saturation, increasing competition, and depressed consumer expenditure, Starbucks' share price fell dramatically. At the board's request, Schultz returned as CEO in January 2008. After two years of turnaround and revitalization, Starbucks' fortunes were restored. Growth had been rekindled, operating profits and margins hit new records (Table 1), and on April 13, 2012, Starbuck's shares closed at an all-time high of $62, up from $10 in March 2009 (Figure 1).

For many observers, including the owners of the Milanese cafes that had provided the inspiration for Starbucks, the Starbucks story is little short of miraculous. America's first coffeehouse had opened in Boston in 1676: how could brewing a better cup of coffee in the 1980s produce a company with a market value of $45 billion? Given the ubiquity of good coffee, could Starbucks possibly sustain its success?

The Starbucks Story

The rise of Starbucks from a single store in Seattle's Pike Place Market to a Fortune 500 company (number 229 on Fortune's 2012 listing) is an exemplary tale of American entrepreneurship.

Starbucks Coffee, Tea and Spice had been founded by college buddies Gerald Baldwin and Gordon Bowker. In 1981, Howard Schultz visited their store. It was a revelation. "I realized the coffee I had been drinking was swill." Captivated by the business potential that Starbucks offered, Schultz encouraged the founders to hire him as head of marketing. Shortly afterwards, Schultz experienced a second revelation. On a trip to Milan, he discovered that drinking coffee was more than experiencing the taste of good coffee: it was the ambiance of the coffee bar, the social

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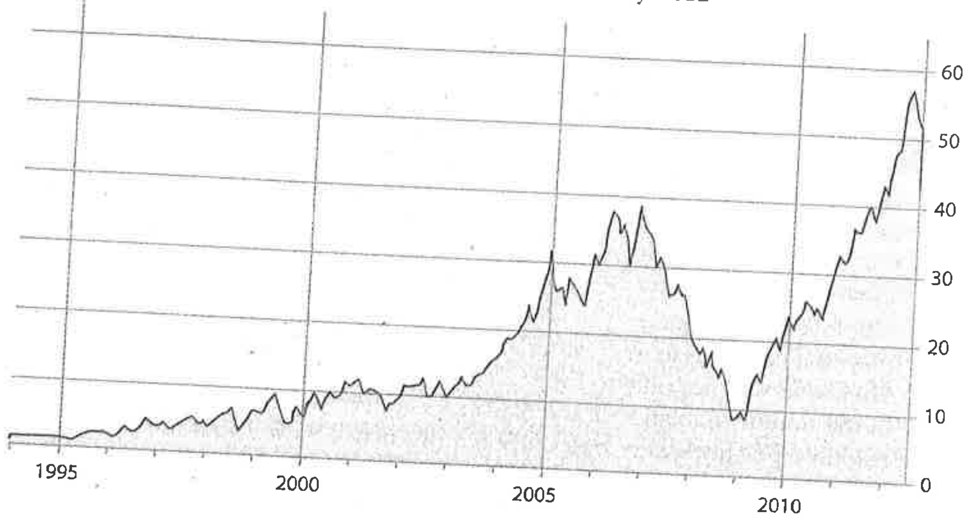
TABLE 1 Starbucks Corporation: Financial and operating performance, 2005–2011

12 months to end-Sept. ($m)	2011	2010	2009	2008	2007	2006	2005
RESULTS OF OPERATIONS							
Net revenues							
Company-operated retail	9,632.4	8,963.5	8,180.1	8,771.9	7,998.3	6,583.1	5,391.9
Specialty	2,068.0	1,743.9	1,594.5	1,611.1	1,413.2	1,203.8	977.4
Total net revenues	11,700.4	10,707.4	9,774.6	10,383.0	9,411.5	7,786.9	6,369.3
Cost of sales	4,949.3	4,458.6	4,324.9	4,645.3	3,999.1	3,178.8	n.a.
Store operating expenses	3,665.1	3,551.4	3,425.1	3,745.1	3,215.9	2,687.8	n.a.
Other operating expenses	402.0	293.2	264.4	330.1	294.2	253.7	n.a.
Depreciation and amortization	523.3	510.4	534.7	549.3	467.2	387.2	n.a.
General and administrative expenses	636.1	569.5	453.0	456.0	489.2	479.4	n.a.
Restructuring charges	—	53.0	3,324.0	266.9	—	—	n.a.
Total operating expenses	10,175.8	9,436.1	9,334.5	9,992.7	8,465.6	6,986.9	n.a.
Operating income	1,728.5	1,419.4	562.0	503.9	1,053.9	894.0	780.5
Net earnings	1,245.7	945.6	390.8	315.5	672.6	564.3	494.4
Net cash from operations	1,612.4	1,704.9	1,389.0	1,258.7	1,331.2	1,131.6	922.9
Capital expenditures (net)	531.9	440.7	445.6	984.5	1,080.3	771.2	643.3
BALANCE SHEET							
Working capital (deficit)	1,719.1	977.3	454.8	(441.7)	(459.1)	(405.8)	(17.7)
Total assets	7,360.4	6,385.9	5,576.8	5,672.6	5,343.9	4,428.9	3,513.7
Short-term borrowings	—	—	—	713.0	710.3	700.0	277.0
Long-term debt	549.5	549.4	549.3	550.3	550.9	2.7	3.6
Shareholders' equity	4,384.9	3,674.7	3,045.7	2,490.9	2,284.1	2,228.5	2,090.3
STORE INFORMATION							
Percentage change in same store sales							
United States (%)	8	7	(6)	(5)	4	7	9
International (%)	5	6	(2)	2	7	8	6
Consolidated (%)	8	7	(6)	(3)	5	7	8
Stores opened during the year (net of closures)							
United States							
Company-operated stores	(2)	(57)	(474)	445	1065	810	580
Licensed stores	(342)	60	35	438	723	733	596
International							
Company-operated stores	144	(16)	105	236	286	240	177
Licensed stores	345	236	289	550	497	416	319
Total	145	223	(45)	1,669	2,571	2,199	1672
Number of stores							
United States							
Company-operated stores	6,705	6,707	6,764	7,238	6,793	5,728	4,918
Licensed stores	4,082	4,424	4,364	4,329	3,891	3,168	2,435
International							
Company-operated stores	2,326	2,182	2,198	2,093	1,831	1,457	1,217
Licensed stores	3,890	3,545	3,309	3,020	2,496	2,087	1,671
Total	17,003	16,858	16,635	16,680	15,011	12,440	10,241

Note:
Figures in parentheses denote a loss.

FIGURE 1 Starbucks' share price ($), May 2004–May 2012



interactions it housed, and the art of the barista in preparing the coffee. His ideas for recreating Starbucks to be a place where people would come to share the experience of drinking great coffee rather than to buy coffee beans failed to persuade the founders. Schultz left to open his own Italian-styled coffee bar, Il Giornale. In 1987, he acquired the Starbucks chain of six stores, merged it with his three Il Giornale bars, and adopted the Starbucks name for the enlarged company.

Schultz's original idea of replicating Italian coffee bars (where customers mostly stand to drink coffee) was adapted to "the American equivalent of the English pub, the German beer garden and the French café."[1] With the addition of Wi-Fi, Starbucks stores became a place to work as well as to socialize. By 1992, Starbucks had grown to 165 outlets and, having gone public, Schultz was able to accelerate that growth using the $27 million from the stock offering. Expansion followed a cluster pattern: opening multiple stores in a single metro area. The idea was to increase Starbucks' local brand awareness and facilitate customers' ability to find a Starbucks close to their home and work. International expansion began with Japan in 1996 and the UK in 1998. Starbucks relied mainly on organic growth, but occasionally Schultz made acquisitions: the UK-based Seattle Coffee Company in 1998, Seattle's Best Coffee and Torrefazione Italia in 2003, and Diedrich Coffee in 2006.

Starbucks' Strategy

Starbucks' strategy was grounded in its mission "to inspire and nurture the human spirit—one person, one cup and one neighborhood at a time." To put this mission into practice required Starbucks to not just serve excellent coffee but also engage its customers at an emotional level. As Schultz explained: "We're not in the coffee business serving people, we are in the people business serving coffee."

Central to the Starbucks' strategy was Schultz's concept of the "Starbucks Experience," which centered on the creation of a "third place"—somewhere other than home and work where people could engage socially while enjoying the shared experience of drinking good coffee. The Starbucks Experience combined several elements:

- Coffee beans of a high, consistent quality and the careful management of a chain of activities that resulted in their transformation into the best possible espresso coffee: "We're passionate about ethically sourcing the finest coffee beans, roasting them with great care, and improving the lives of the people who grow them." The appendix at the end of this case explains the arrangements under which Starbucks sourced its coffee beans (see "Product Supply").
- Employee involvement. The counter staff at Starbucks stores—the baristas—played a central role in creating and sustaining the Starbucks Experience. Their role was not only to brew and serve coffee but to engage customers in the unique ambiance of the Starbucks coffee shop. Starbucks' human resource practices were based upon a distinctive view about the company's relationship with its employees. If Starbucks was to engage customers in an experience which extended beyond the provision of good coffee, then it was going to have to employ the right store employees who would be the critical providers of this experience. This required employees who were committed and enthusiastic communicators of the principles and values of Starbucks. This in turn required the company to regard its employees as business partners. Starbucks' human resource practices were tailored, first, to attracting and recruiting people whose attitudes and personalities were consistent with the culture of the company and, second, to foster trust, loyalty, and a sense of belonging, which would, in turn, facilitate their engagement with the Starbucks' experience. Starbucks selected employees with care and rigor, placing a heavy emphasis on adaptability, dependability, capacity for teamwork, and willingness to further Starbucks' principles and mission. Its training program extended beyond basic operational and customer-service skills and placed particular emphasis on educating employees about coffee. Unique among catering chains, Starbucks provided health insurance for almost all regular employees, including part-timers.
- Community relations and social purpose. Schultz viewed Starbucks as part of a broader vision of common humanity: "I wanted to build the kind of company my father never had the chance to work for, where you would be valued and respected wherever you came from, whatever the color of your skin, whatever your level of education. Offering healthcare was a transforming event in the equity of the Starbucks brand that created unbelievable trust among our people. We wanted to build a company that linked shareholder value to the cultural values that we want to create with our people."[2] Schulz's vision was of a company that would earn good profits but would also do good in the world. This began at the local level: "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." It extended to Starbuck's global role: "we have the opportunity to be a different type of global company. One that makes a profit but at the same time demonstrates a social conscience."

- The layout and design of Starbucks stores were seen as critical elements of the experience. Starbucks has a store design group that is responsible for the design of the furniture, fittings, and layout of Starbucks' retail outlets. Like everything else at Starbucks, store design is subject to meticulous analysis and planning, following Schultz's dictum that "retail is detail." While every Starbucks store is adapted to reflect its unique neighborhood, "there is a subliminal unifying theme to all the stores that ties into the company's history and mission—'back to nature' without the laid-back attitude; community-minded without stapled manifestos on the walls. The design of a Starbucks store is intended to provide both unhurried sociability and efficiency on-the-run, an appreciation for the natural goodness of coffee and the artistry that grabs you even before the aroma. This approach is reflected in the designers' generous employment of natural woods and richly layered, earthy colors along with judicious high-tech accessorizing . . . No matter how individual the store, overall store design seems to correspond closely to the company's first and evolving influences: the clean, unadulterated crispness of the Pacific Northwest combined with the urban suavity of an espresso bar in Milan."[3]
- Starbucks' location strategy—its clustering of 20 or more stores in each urban hub—was viewed as enhancing the experience both in creating a local "Starbucks buzz" and in facilitating loyalty by Starbucks' customers. Starbucks' analysis of sales by individual store found little evidence that closely located Starbucks stores cannibalized one another's sales. To expand sales of coffee-to-go, Starbucks began adding drive-through windows to some of its stores and building new stores adjacent to major highways.

Diversification

Broadening Starbucks' product range was partly about responding to customer demand (for example requests for iced coffee eventually led to Frappuccino) and partly about building the Starbucks Experience. "The overall strategy is to build Starbucks into a destination," explained Kenneth Lombard, then head of Starbucks Entertainment. This involved adding food, music, books, and videos. As a music publisher and retailer of CDs, Starbucks was hugely successful, particularly its "Artists Choice" series where well-known musicians chose their favorite tracks. "I had to get talked into this one," says Schultz. "But then I began to understand that our customers looked to Starbucks as a kind of editor. It was like, 'We trust you. Help us choose.'"

Increasingly, Starbucks diversified its business model to include other ownership and management formats, additional products, and different channels of distribution. These included:

- Licensed coffee shops and kiosks. The desire to reach customers in a variety of locations eventually caused Starbucks to abandon its policy of only selling through company-owned outlets. Its first licensing deal was with Host Marriot, which owned food and beverage concessions in several US airports. This was followed by licensing arrangements with Safeway and Barnes & Noble for opening Starbucks coffee shops in their stores. Overseas, Starbucks increasingly relied upon licensing arrangements with local companies.
- Distribution of Starbucks retail packs of Starbucks coffee through supermarkets and other retail food stores.

- Licensing of Starbucks brands to PepsiCo and Unilever for the supply of Starbucks bottled drinks (such as Frappuccino and Tazo teas).
- Starbucks' involvement in financial services began with its Starbucks prepaid store card, which was later combined with a Visa credit card (the Starbucks/Bank One Duetto card). The Starbucks card allowed entry to the Starbucks reward program, which offered free drinks and other benefits to regular customers.

Reformulating the Strategy, 2008–2012

After 20 years of continuous expansion accompanied by rising profits and a soaring stock price, Starbucks' downturn was unexpected and rapid. Starbucks' stock-market valuation was the leading indicator of the problems to come. After reaching a peak of $40 in October 2006, the share price declined by more than 75% over the next two years (Figure 1). During 2007, growth of same-store sales and operating profits slowed. Amidst increasing concern over Starbucks' current strategy and future prospects and convinced that the source of Starbucks' woes was the compromising of Starbucks' core values that had resulted from the company's growth spurt, chairman and founder Howard Schultz returned as CEO at the beginning of 2008. Starbucks' financial results for 2008 and 2009 revealed how Starbucks' performance had deteriorated (Table 1).

Getting Starbucks Back on Track

Schultz based his turnaround strategy on two major thrusts. First was retrenchment. Soon after his reappointment as CEO, Schultz announced a sharp cutback in planned US new store openings and revised operational practices to improve cost efficiency. In the summer of 2008, Schultz announced the closure of 600 US stores and the majority of its stores in Australia. The store closures resulted in almost 6,000 job losses; in addition, 700 positions were cut in corporate and support positions. The cost cutting extended to the office of the CEO: Schultz cut his own salary from $1.2 million to $10,000 and put two of Starbucks' three corporate jets up for sale. This reduced operating costs by $500 million in 2009.[4]

The second thrust was the reaffirmation of Starbucks' values and business principles, including revitalization of the "Starbucks Experience" and reconnection with its customers. Reinvigorating Starbucks' social commitment played a central role in the rediscovery process. During 2008, a company-wide reconsideration of Starbucks' purpose and principles resulted in a revised mission statement and a stronger commitment to corporate social responsibility. Starbucks' 2008 annual leadership meeting was held in New Orleans where 10,000 Starbucks employees participated in a variety of community projects for cleanup and restoration in the aftermath of Hurricane Katrina. Other initiatives included the launch of Starbucks Shared Planet: an environmental sustainability and community service program.

Schultz reviewed operating practices to examine their consistency with the Starbucks Experience and Starbucks' image. One key change was a return to "handmade" coffee. To speed up coffee making, Starbucks had replaced its La Marzocco espresso machines, which required baristas to grind coffee for each cup, with automatic Verismo machines, which merely required baristas to press a button. During 2008, Starbucks spent millions installing new coffee machines where cups of coffee were made individually from freshly ground beans. Schultz pushed for a review and revision of Starbucks' food menu. A key change was withdrawing toasted breakfast sandwiches whose aromas masked that of the coffee: "The breakfast sandwiches drive revenue and profit but they are in conflict with everything we stand for in terms of the coffee and the romance of the coffee."[5]

Reconnecting with customers involved extensive use of social media: Starbucks was a pioneer in using Facebook for promotional and loyalty-building purposes. In collaboration with Square Inc., it pioneered the use of mobile payments through its Starbucks card. Using the Starbucks card apps (for Android and iPhone), Starbucks cardholders could use their cell phones to pay at Starbucks stores and to automatically recharge their cards.

Most of all, Schultz traveled Starbuck's far-flung empire to meet with employees ("partners") to reinforce Starbucks' values, and to reignite their drive and enthusiasm. At a series of meetings held in concert halls and other venues, Schultz recounted inspiring tales that exemplified the "humanity of Starbucks" and the role that managers played in creating an experience that "values and respects" customers. At the same time Schultz challenged his store managers with the severity of the current situation, with the need to return to the values and practices that had made Starbucks a special place, and the efforts that would be required to lift Starbucks' performance.[6]

By re-emphasizing Starbucks' core values, reversing store expansion, eliminating non-core products, and returning to the quality of the coffee and customer service, Schultz viewed his role as putting Starbucks back on the right road after a period in which growth had become "carcinogenic":

> When you look at growth as a strategy, it becomes somewhat seductive, addictive. But growth should not be—and is not—a strategy; it's a tactic. The primary lesson I've learned over the years is that growth and success can cover up a lot of mistakes . . . When we reviewed some of the underperforming stores, I was horrified to learn that the stores that we ultimately had to close had been open less than 18 months. When you look at that—the money invested and the money that we had to write off—those decisions were made with a lack of discipline. Also, I think there were times, during that period when we were chasing growth, when we were making decisions that were kind of complicit with the stock price. That's a very, very dangerous road to go down.[7]

Return to Growth

With operational efficiency and customer connections restored, Starbucks' food offerings revamped, and commitment to the company's values and principles reinvigorated, Starbucks' increasingly shifted its emphasis to growth opportunities. The difference, according to Schultz, was that growth would be "disciplined." Revenue growth was sought in two main areas: the grocery trade and international markets.

New Products and Alternative Distribution Channels A key thrust was to grow Starbuck's brand and product positioning within the grocery sector. The most significant move on this front was the introduction of Via, a new type of instant coffee, launched in February 2009 at $2.95 for a pack of three individual servings and $9.95 for 12 servings. Via used a patented process which allowed the company to "absolutely replicate the taste of Starbucks coffee." In less than two years, Via's sales reached $200 million. Other products for making coffee at home included single-serving K-Cups (for use with Green Mountain's Keurig coffee makers and Starbucks' own Verismo coffee pod espresso system. Starbucks also sought to expand sales under its Seattle's Best Coffee brand. In November 2011, Starbucks acquired premium juice maker Evolution Fresh Inc. with a view to expanding retail distribution of fruit juices and to open its own juice bars.

Under Schultz's leadership Starbucks' Consumer Products Group became the fastest-growing part of the company. A key feature of its strategy was exploiting complementarities between Starbucks' coffeehouses and the retail trade. Schultz explained the business model:

> Starbucks can seed and introduce new products and new brands inside our stores. We introduced Via instant coffee in our stores. Instant coffee is a $24 billion global category that has not had any innovation in over 50 years. And no growth. If we took Via and we put it into grocery stores and it sat on a shelf, it would have died. But we can integrate Via into the emotional connection we have with our customers in our stores. We did that for six to eight months and succeeded well beyond expectations in our stores. And as a result of that, we had a very easy time convincing the trade, because they wanted it so badly.[8]

This integration of the use of Starbucks' stores to lead sales through traditional grocery channels is outlined in Figure 2.

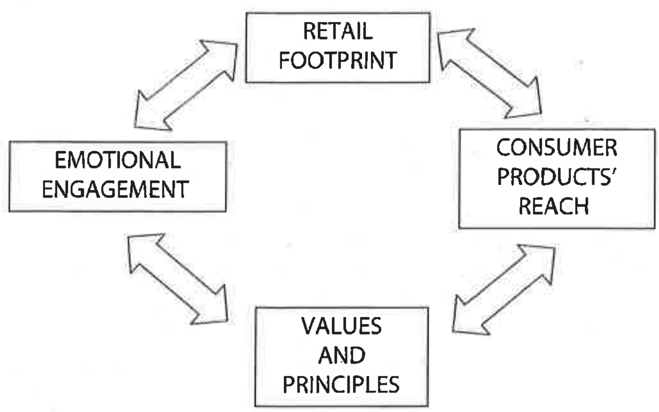
An indication of increased strategic focus on the grocery trade was Starbucks' decision to withdraw from its agreement with Kraft Foods for the distribution of its packaged coffees, in order for Starbucks to undertake its own distribution.

International Expansion Schultz viewed emerging markets, China in particular, as a huge opportunity for Starbucks:

> The big opportunity, in terms of total stores, is what's happening in China; we've got 800 stores in greater China, 400 in the mainland. When all is said and done, we'll have thousands. We're highly profitable there. We've been there 12 years, and I would say that the hard work—in terms of building the foundation to get access to real estate, design stores, and operate them—is well in place.[9]

India was next: in January 2012, Starbucks announced the formation of a 50/50 joint venture with Tata Global Beverages to establish a chain of Starbucks coffeehouses in India.

FIGURE 2 Starbucks' "Blueprint for Profitable Growth"



"Blueprint for Profitable Growth" By early 2011, Starbucks was able to articulate its strategy for expansion as its "Blueprint for Profitable Growth." At the base of the model were Starbucks' values and business principles. According to Schultz: "Over our 40-year history, we have built the Starbucks brand with a goal of staying true to our values and our guiding principles with a deep sense of humanity. Going forward, we will continue to focus on what made us a different kind of company, one that balances profitability and social conscience while providing exceptional shareholder value."[10] This in turn provided the basis for Starbucks' emotional engagement with its customers. In addition to the face-to-face engagement cultivated through Starbucks' in-store experience, Starbucks' increasingly sought to use social networking and other digital media in order to extend and deepen its relationships with customers. Simultaneously, Starbucks would expand the scope of its customer engagement through growing its network of stores both through geographical expansion and seeking new opportunities through licensing. For example, through its alliance with Autogrill's HMSHost, Starbucks would expand beyond the 360 Starbucks locations currently operated by HMSHost in airports, on motorways, and in railway stations in North America and Europe. To exploit its growing brand strength, customer awareness, and loyalty, Starbucks would then expand its offerings of consumer products in the grocery trade and other distribution channels.

The Market for Coffee

Table 2 shows the world's leading importers of coffee and indicates per capita consumptions of coffee (the table omits coffee-producing countries with high per capita consumption such as Brazil, Costa Rica, and Vietnam).

TABLE 2 The world's leading coffee importing countries, 2006

Country	Imports (million kg)	Imports per head (kg)
United States	1,428.30	4.78
Germany	1,126.14	13.66
Japan	475.80	3.72
Italy	456.00	7.73
France	367.74	6.01
Belgium/Luxembourg	275.82	25.10
Spain	271.50	6.00
Canada	256.26	7.86
United Kingdom	241.98	4.00
Netherlands	195.48	11.92
Russia	188.22	1.33
Poland	167.52	4.40
Sweden	121.74	13.37
Austria	115.50	13.92
Algeria	109.26	3.26
Korea, Republic of	100.02	2.06
Switzerland	92.34	12.31
Australia	79.80	3.87

The US is the world's biggest market for coffee. Expenditure on coffee (for consumption at home, at work, and at catering establishments) was estimated at $47.5 billion in 2011. The market was split roughly equally between sales for the home-brewed coffee and sales of ready-brewed coffee. The market for the former was declining, while the latter was growing.

The US market could also be segmented between "ordinary" coffee and "specialty" coffee (also known as "premium" or "gourmet" coffee). Also, specialty coffeehouses had been a feature of US cities, especially those of the east and west coasts, for many decades. Starbucks' achievement had been to bring quality coffee to the mass market. Sales of premium brewed coffee were estimated to have grown from about $3.5 billion in 2000 to about $12 billion in 2011, with the number of coffee shops roughly doubling over the same period to reach 28,000.

Although Starbucks had been the primary driver of this growth, its success had spawned many imitators. These included both independent coffeehouses and chains, most of which were local or regional, although some aspired to grow into national chains. Table 3 identifies some of the leading chains.

In addition to specialty coffeehouses, most catering establishments in the US, whether restaurants or fast-food chains, served coffee as part of a broader menu of food and beverages. Increasingly, these outlets were seeking to compete more directly with Starbucks by adding premium coffee drinks to their menus. McDonald's had introduced a premium coffee (which consumer reports rated more highly than Starbucks' coffee) and had added its McCafés to a growing proportion of its burger restaurants both in North America and Europe. Burger King and Dunkin' Donuts had also moved upmarket in their coffee offerings. McDonald's and Dunkin' Donuts both targeted Starbucks in their advertising. The McDonald's web site Unsnobbycoffee.com implicitly identified Starbucks as overpriced and "snobbish."

Outside of the US, Starbucks faced different competitive situations country by country. In most of them, competition was even more intense than in the US. Starbucks' withdrawal from Australia was a consequence of a highly sophisticated coffee market developed and educated by Italian, southern European, and the Middle Eastern immigrants. Throughout continental Europe Starbucks had to deal with well-developed markets with high standards of coffee preparation and strong local preferences.

TABLE 3 Leading chains of coffee shops in the US, 2011

Company	US outlets, 2011	Headquarters
Starbucks	10,789	Seattle, WA
Tim Hortons	714	Oakville, Ontario
Caribou Coffee	415	Brooklyn Center, MN
Coffee Bean and Tea Leaf	296	Los Angeles, CA
Peet's Coffee	193	Emeryville, CA
Tully's Coffee	180	Seattle
Coffee Beanery	131	Flushing, MI
It's A Grind Coffeehouse	105	Long Beach, CA
Dunn Bros	85	St Paul, MN
PJ's Coffee	50	New Orleans, LA
Port City Java	32	Wilmington, NC

As well as competition from the bottom (McDonald's, Dunkin' Donuts), Starbucks faced competition from the top. The upmarket Italian coffee roaster illycaffè S.p.A was expanding in the US through franchise arrangements with independent coffeehouses. One scenario for the US gourmet coffee market was that once Starbucks had educated North Americans about the joy of good coffee these new coffee connoisseurs would go on to seek superior alternatives to Starbucks.

The specialty coffee market was also seeing a revolution in home-brewed coffee. Sales of Italian-style espresso coffee makers (which used highly pressurized hot water to make coffee) had grown rapidly since 2000. A particular growth area had been single-serve coffee pod systems pioneered by Nestlé's Nespresso subsidiary. Other entrants into this market had been Keurig with its K-Cup system, the Senseo system launched by Philips and Sara Lee, and Kraft's Tassimo system. In 2010, Lavazza S.p.A and Green Mountain Coffee Roasters Inc. created an alliance to develop a new range of single-serve espresso coffee makers. In March 2012, Starbucks joined the fray by launching its own single serve, home coffee makers under its Verismo brand.

Looking Ahead

The release of Starbucks quarterly financial results on April 26, 2012 offered further confirmation of the strength of Starbucks' recovery under Schultz's leadership and reinforced the view that the downturn of 2007/2008 had been an aberration resulting from Starbuck's overeager pursuit of growth (Table 4).

Yet amidst the acclaim for Schultz's remarkable success in returning Starbucks to profitability and growth, many of the concerns that had worried investment analysts in 2008 had not disappeared: the US recovery and the world economy remained

TABLE 4 Starbucks Corporation: Results for three quarters ending July 1, 2012

	9 months ending July 1, 2012	9 months ending July 3, 2011	Change
TOTAL COMPANY			
Net new stores	648	160	+488
Revenues ($m)	9,935	8,669	+15%
Of which: Company-owned stores ($m)	7,869	7,162	+10%
—Licensed stores ($m)	905	741	+22%
—CPG, foodservice, and other ($m)	1,162	766	+52%
Operating income ($m)	1,478	1,280	+15%
Operating margin	14.9%	14.8%	+0.1%
REVENUES BY REGION			
Americas	7,424	6,769	+10%
Europe, Middle East, Africa	858	757	+13%
China, Asia-Pacific	523	391	+34%
Channel Development[a]	974	618	+58%

Note:

[a]Comprises Consumer Products Group and Foodservice.

Source: US Securities and Exchange Commission, Starbucks Corporation, Form 10-Q, Quarterly Period Ended July 1, 2012, File Number: 0-20322, Washington, DC 20549.

fragile and the competitive forces that had threatened Starbucks in 2008 appeared even stronger in 2012. Some had doubts about the consistency and coherence of Starbucks' strategy. After refocusing Starbucks on its core values and core identity, might Schultz's multiple initiatives be a distraction for the company? For those who had perceived an uneasy relationship between Starbucks' claim to be providing authentic, gourmet coffee and its offerings of syrup-flavored coffees, the introduction of instant coffee was viewed as brand-threatening. Starbuck's push into the grocery trade was taking the company into an intensely competitive field where it would need to develop new capabilities. Barclays Capital analyst Jeff Bernstein commented: "They're starting a new chapter from scratch. While viewed favorably by most, the question has to be: Do you realize the magnitude of the task you're taking on?"[11]

Appendix: Extracts from Starbucks Corporation 10-K Report for Fiscal Year 2011

The Business

General Starbucks is the premier roaster, marketer and retailer of specialty coffee in the world, operating in more than 50 countries. Formed in 1985, Starbucks Corporation's common stock trades on the NASDAQ Global Select Market ("NASDAQ") under the symbol "SBUX." We purchase and roast high-quality whole bean coffees that we sell, along with handcrafted coffee and tea beverages and a variety of fresh food items, through company-operated stores. We also sell a variety of coffee and tea products and license our trademarks through other channels such as licensed stores, grocery and national foodservice accounts. In addition to our flagship Starbucks brand, our portfolio also includes Tazo® Tea, Seattle's Best Coffee®, and Starbucks VIA® Ready Brew.

Our objective is to maintain Starbucks standing as one of the most recognized and respected brands in the world. To achieve this goal, we are continuing the disciplined expansion of our store base, primarily focused on growth in countries outside of the US. In addition, by leveraging the experience gained through our traditional store model, we continue to offer consumers new coffee products in multiple forms, across new categories, and through diverse channels. Starbucks Global Responsibility strategy and commitments related to coffee and the communities we do business in, as well as our focus on being an employer of choice, are also key complements to our business strategies.

Company-operated Stores Revenue from company-operated stores accounted for 82% of total net revenues during fiscal 2011. Our retail objective is to be the leading retailer and brand of coffee in each of our target markets by selling the finest quality coffee and related products, and by providing each customer a unique *Starbucks Experience*. The *Starbucks Experience* is built upon superior customer service as well as clean and well-maintained company-operated stores that reflect the personalities of the communities in which they operate, thereby building a high degree of customer loyalty.

Our strategy for expanding our global retail business is to increase our market share in a disciplined manner, by selectively opening additional stores in new and existing markets, as well as increasing sales in existing stores, to support our long-term strategic objective to maintain Starbucks standing as one of the most recognized and respected brands in the world. Store growth in specific existing markets will vary due to many factors, including the maturity of the market.

A summary of total company-operated store data for the periods indicated

	Net stores opened year ending		Stores open as of	
	Oct. 2, 2011	Oct. 3, 2010	Oct. 2, 2011	Oct. 3, 2010
United States	(2)	(57)	6,705	6,707
Canada	37	24	836	799
United Kingdom	6	(65)	607	601
China	58	29	278	220
Germany	8	(2)	150	142
Thailand	8	2	141	133
Other	27	(3)	314	287
Total International	144	(15)	2,326	2,182
Total Company-operated	142	72	9,031	8,889

Starbucks retail stores are typically located in high-traffic, high-visibility locations. Our ability to vary the size and format of our stores allows us to locate them in or near a variety of settings, including downtown and suburban retail centers, office buildings, university campuses, and in select rural and off-highway locations. To provide a greater degree of access and convenience for non-pedestrian customers, we continue to selectively expand development of drive-thru retail stores.

Starbucks stores offer a choice of regular and decaffeinated coffee beverages, a broad selection of Italian-style espresso beverages, cold blended beverages, iced shaken refreshment beverages, a selection of premium teas, distinctively packaged roasted whole bean coffees, and a variety of Starbucks VIA® Ready Brew soluble coffees. Starbucks stores also offer a variety of fresh food items, including selections focusing on high-quality ingredients, nutritional value and great flavor. Food items include pastries, prepared breakfast and lunch sandwiches, oatmeal and salads, as well as juices and bottled water. In addition to being offered in our US and Canada stores, during fiscal 2011, we expanded our food warming program into our stores in China, with over 90% of the stores in these markets providing warm food items as of the end of fiscal 2011. A focused selection of beverage-making equipment and accessories are also sold in the stores. Each Starbucks store varies its product mix depending upon the size of the store and its location. To complement the in-store experience, in company-operated Starbucks stores in the US, we also provide customers free access to wireless internet.

Retail sales mix by product type for company-operated stores

Fiscal year ended	Oct. 2, 2011	Oct. 3, 2010	Sep. 27, 2009
Beverages (%)	75	75	76
Food (%)	19	19	18
Coffee-making equipment & other merchandise (%)	4	4	3
Whole bean coffees (%)	2	2	3
Total (%)	100	100	100

Licensed Stores Product sales to and royalty and license fee revenues from US and International licensed stores accounted for 9% of total revenues in fiscal 2011. In our licensed store operations, we leverage the expertise of our local partners and share our operating and store development experience. Licensees provide improved, and at times the only, access to desirable retail space. Most licensees are prominent retailers with in-depth market knowledge and access. As part of these arrangements, we receive royalties and license fees and sell coffee, tea and related products for resale in licensed locations. Employees working in licensed retail locations are required to follow our detailed store operating procedures and attend training classes similar to those given to employees in company-operated stores. For our Seattle's Best Coffee brand, we use various forms of licensing, including traditional franchising.

Starbucks total licensed stores by region and country as of October 2, 2011

Asia Pacific		**Europe/Middle East/Africa**		**Americas**	
Japan	935	Turkey	153	United States	4,082[a]
South Korea	367	UK	128	Mexico	318
Taiwan	221	United Arab Emirates	94	Canada	284
China	218	Spain	75	Other	92
Philippines	183	Kuwait	67		
Malaysia	121	Saudi Arabia	65		
Hong Kong	117	Greece	59		
Indonesia	109	Russia	52		
New Zealand	35	Other	169		
Total	2334	Total	862	Total	4,776

Note:
[a]Includes closure of 475 Seattle's Best Coffee locations in Borders Bookstores.

Consumer Packaged Goods Consumer packaged goods includes both domestic and international sales of packaged coffee and tea to grocery and warehouse club stores. It also includes revenues from product sales to and licensing revenues from manufacturers that produce and market Starbucks and Seattle's Best Coffee branded products through licensing agreements. Revenues from sales of packaged coffee and tea comprised 4% of total net revenues in fiscal 2011. In prior years through the first several months of fiscal 2011, we sold a selection of Starbucks and Seattle's Best Coffee branded packaged coffees and Tazo® teas in grocery and warehouse club stores throughout the US and to grocery stores in Canada, the UK and other European countries through a distribution arrangement with Kraft Foods Global, Inc. Kraft managed the distribution, marketing, advertising and promotion of these products as a part of that arrangement. During fiscal 2011, we successfully transitioned these businesses, including the marketing, advertising, and promotion of these products, from our previous distribution arrangement with Kraft and began selling these products directly to the grocery and warehouse club stores. We also sell packaged coffee and tea directly to warehouse club stores in international markets.

Revenues from licensing our branded products accounted for 1% of total net revenues in fiscal 2011. We license the rights to produce and market Starbucks and Seattle's Best Coffee branded products through several partnerships both domestically and internationally. We also sell ingredients to these licensees to manufacturer our branded products. Significant licensing agreements include:

- The North American Coffee Partnership, a joint venture with the Pepsi-Cola Company in which Starbucks is a 50% equity investor, manufactures and markets ready-to-drink beverages, including bottled Frappuccino® beverages and Starbucks DoubleShot® espresso drink and Seattle's Best Coffee® ready-to-drink espresso beverages in the US and Canada;
- licensing agreements with Arla, Suntory, and Dong Suh Foods for the manufacturing, marketing and distribution of Starbucks Discoveries®, a ready-to-drink chilled cup coffee beverage, in Europe, Japan and South Korea, respectively;
- a licensing agreement with a partnership formed by Unilever and Pepsi-Cola Company for the manufacturing, marketing and distribution of Starbucks super-premium Tazo® Tea beverages in the US; and
- a licensing agreement with Unilever for the manufacturing, marketing and distribution of Starbucks® super-premium ice cream products in the US.

Foodservice Revenues from foodservice accounts comprised 4% of total net revenues in fiscal 2011. We sell Starbucks® and Seattle's Best Coffee® whole bean and ground coffees, a selection of premium Tazo® teas, Starbucks VIA® Ready Brew, and other related products to institutional foodservice companies that service business and industry, education, healthcare, office coffee distributors, hotels, restaurants, airlines and other retailers. We also sell our Seattle's Best Coffee® through arrangements with national accounts. The majority of the sales in this channel come through national broadline distribution networks with SYSCO Corporation, US Foodservice™, and other distributors.

Product Supply Starbucks is committed to selling only the finest whole bean coffees and coffee beverages. To ensure compliance with our rigorous coffee standards, we control coffee purchasing, roasting and packaging, and the global distribution of coffee used in our operations. We purchase green coffee beans from multiple coffee-producing regions around the world and custom roast them to our exacting standards, for our many blends and single origin coffees. We buy coffee using fixed-price and price-to-be-fixed purchase commitments, depending on market conditions, to secure an adequate supply of quality green coffee . . .

We depend upon our relationships with coffee producers, outside trading companies and exporters for our supply of green coffee. We believe, based on relationships established with our suppliers, the risk of non-delivery on such purchase commitments is remote.

To help ensure sustainability and future supply of high-quality green coffees and to reinforce our leadership role in the coffee industry, Starbucks operates Farmer Support Centers in Costa Rica and Rwanda, among other locations. The Farmer Support Centers are staffed with agronomists and sustainability experts who work with coffee farming communities to promote best practices in coffee production designed to improve both coffee quality and yields.

Global Responsibility We are committed to being a deeply responsible company in the communities where we do business around the world. Our focus is on ethically sourcing high-quality coffee, reducing our environmental impacts and contributing positively to communities. Starbucks Global Responsibility strategy and commitments are integral to our overall business strategy. As a result, we believe we deliver benefits to our stakeholders, including employees, business partners, customers, suppliers, shareholders, community members and others. For an overview of Starbucks Global Responsibility strategy and commitments, please visit www.starbucks.com.

Operating Segments

The following tables summarize our results of operations by segment for fiscal 2011 and 2010.

United States

Fiscal year ended	Oct. 2011 ($million)	Oct. 2010 ($million)	Oct. 2011 (as % of total net revenues)	Oct. 2010 (as % of total net revenues)
Total net revenues	8,038.0	7,560.4	100.0	100.0
Cost of sales incl. occupancy costs	3,093.9	2,906.1	38.5	38.4
Store operating expenses	2,891.3	2,831.9	36.0	37.5
Other operating expenses	62.7	204.8	0.8	0.7
Depreciation and amortization	343.8	350.7	4.3	4.6
General & administrative expenses	83.7	85.9	1.0	1.3
Restructuring charges	—	27.2	—	0.4
Total operating expenses	6,475.4	6,279.3	80.6	82.9
Operating income	1,562.6	1291.1	19.4	17.1

International

Fiscal year ended	Oct. 2011 ($million)	Oct. 2010 ($million)	Oct. 2011(as % of total net revenues)	Oct. 2010(as % of total net revenues)
Total net revenues	2,626.1	2,288.8	100.0	100.0
Cost of sales incl. occupancy costs	1,259.8	1,078.2	48.0	47.1
Store operating expenses	773.8	719.5	29.5	31.4
Other operating expenses	91.9	85.7	3.5	3.4
Depreciation & amortization	118.5	108.6	4.5	4.7
General & administrative expenses	132.9	126.6	5.1	5.5
Restructuring charges	—	25.8	—	1.1
Total operating expenses	2,376.9	2,144.4	90.5	93.7
Income from equity investees	100.5	80.8	3.8	3.5
Operating income	349.7	225.2	13.3	9.8

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Global Consumer Products Group

Fiscal year ended	Oct. 2011 ($million)	Oct. 2010 ($million)	Oct. 2011 (as % of total net revenues)	Oct. 2010 (as % of total net revenues)
Total net revenues	860.5	707.4	100.0	100.0
Cost of sales incl. occupancy costs	492.5	384.9	57.2	54.4
Other operating expenses	153.9	117.0	17.9	16.5
Depreciation & amortization	2.4	3.7	0.3	0.5
General & administrative expenses	14.3	11.0	1.7	1.6
Total operating expenses	663.1	516.6	77.1	73.0
Income from Equity Investees	75.6	70.6	8.8	10.0
Operating income	273.0	261.4	31.7	37.0

Other[a]

Fiscal year ended	Oct 2, 2011 ($m)	Oct 3, 2010 ($m)	Change %
Total net revenues	175.8	150.8	16.6
Cost of sales	103.1	89.4	15.3
Other operating expenses	93.5	34.9	167.9
Depreciation & amortization	58.6	47.4	23.6
General & administrative expenses	405.2	334.1	21.3
Total operating expenses	660.4	505.8	30.6
Gain on sale of properties	30.2	0.0	n.m.
Loss from equity investee	(2.4)	(3.3)	(27.3)
Operating loss	(456.8)	(358.3)	27.5

Note:
[a]*Other* comprises the Seattle's Best Coffee operating segment, the Digital Ventures business, and expenses pertaining to certain corporate administrative functions. Revenues are mainly from Seattle's Best Coffee.

Notes

1. J. Wiggins "When the Coffee Goes Cold," *Financial Times* (December 13, 2008).
2. Quoted in: *Howard Schultz: Building the Starbucks Community* (Harvard Business School Case No. 9-406-127, 2006).
3. "Starbucks: A Visual Cup o' Joe, "Contemporary Design Foundation," www.cdf.org/issue_journal/starbucks_a_visual_cup_o_joe.html, accessed May 15, 2009.
4. Starbucks Corporation, press release, Starbucks Reports First Quarter Fiscal 2009 Results (January 28, 2009).
5. M. Allison, "Schultz Concerned about Consumers, Not Competitors," *Seattle Times* (January 31, 2008), http://seattletimes.com/html/businesstechnology/2004155269_starbucksadd31.html, accessed August 30, 2012.
6. A meeting at London's Barbican Center is described in J. Wiggins "When the Coffee Goes Cold," *Financial Times* (December 13, 2008).
7. "Starbucks' Quest for Healthy Growth: An Interview with Howard Schultz," *McKinsey Quarterly* (March 2011).
8. "Starbucks' Quest for Healthy Growth: An Interview with Howard Schultz," *McKinsey Quarterly* (March 2011).
9. "Starbucks' Quest for Healthy Growth: An Interview with Howard Schultz," *McKinsey Quarterly* (March 2011).
10. "Starbucks Outlines Blueprint for Profitable Growth at Annual Shareholders Meeting," Starbucks Corporation press release (March 23, 2011).
11. "Latest Starbucks Concoction: Juice," *Wall Street Journal* (November 11, 2011).

A video clip relating to this case is available in your interactive e-book at **www.wileyopenpage.com**