CORK INSTITUTE OF TECHNOLOGY
INSTITIÚID TEICNEOLAÍOCHTA CHORCAÍ

Semester 2 Examinations 2010

Module Title: Integrated Case Study

Module Code: **MGMT7010**

School: Business – Continuing Education

Programme Title: **BA Human Resource Management**

Programme Code: **BHRMN_7_Y2**

External Examiner(s): **Dr. Brigid Milner**
Internal Examiner(s): **Ms. Deborah Harrington**

Instructions: **Answer 5 questions**

Duration: 3 Hours

Sitting: Summer 2010

Requirements for this examination:

Note to Candidates: Please check the Programme Title and the Module Title to ensure that you have received the correct examination paper.
If in doubt please contact an Invigilator.

A case study is attached. You should read this in detail before attempting the questions below. Also attached are two templates to assist in the completion of the PEST and SWOT questions. You should bullet point on the template and expand your answer in your exam script.

Q1. Conduct a SWOT analysis of Starbucks Corporation. (20 marks)

Q2. Conduct a PEST analysis of Starbucks Corporation. (15 marks)

Q3. Describe Starbuck's competitive environment using Porters Five Forces. (20 marks)

Q4. Describe the organisational culture within Starbucks using definitions and models of culture with which you are familiar.

(25 marks)

Q5. Critically examine the key aspects of Starbucks's human resource management policies and discuss the impact of these policies on the organisation.

(20 marks)

PEST ANALYSIS
SWOT ANALYSIS

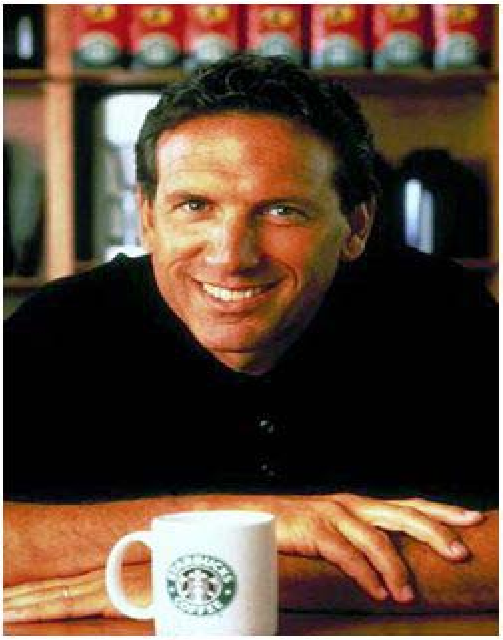
POLITICAL	ECONOMIC	SOCIOCULTURAL	TECHNOLOGICAL

Strengths	Weaknesses	Opportunities	Threats

STARBUCKS COFFEE COMPANY

The relationship we have with our people and the culture of our company is our most sustainable competitive advantage."

-Howard Schultz, chairman and chief global strategist of Starbucks, in 2002.

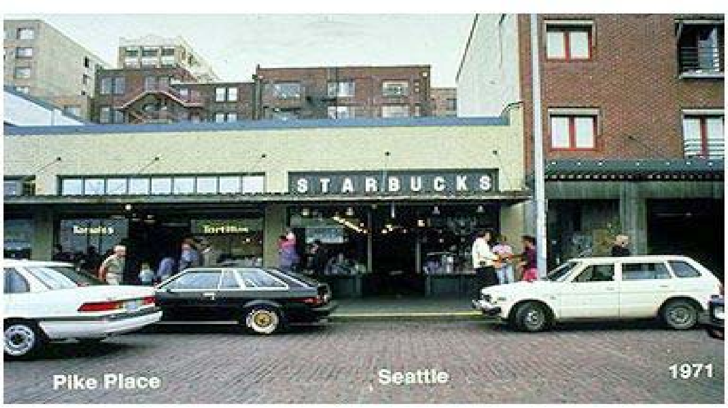


Howard Schultz has ample reason to be proud of what Starbucks has accomplished. The company has enjoyed phenomenal growth and become one of the great retailing stories of recent history by making exceptional coffee drinks and selling dark-roasted coffee beans and coffee-making equipment that would allow customers to brew an exceptional cup of coffee at home. The Starbucks brand is regarded as one of the best known and most potent brand names in America and the company has firmly established itself as the dominant retailer, roaster, and brand of specialty coffee in North America.

Company Background

Starbucks began in 1971 when three academics—English teacher Jerry Baldwin, history teacher Zev Siegel, and writer Gordon Bowker—opened a store called Starbucks Coffee, Tea, and Spice in the touristy Pikes Place Market in Seattle. The three partners shared a love of fine coffees and exotic teas and believed they could build a clientele in Seattle much like that which had already emerged in the San Francisco Bay area. Each invested $1,350 and borrowed another $5,000 from a bank to open the Pikes Place store. Baldwin, Siegel, and Bowker chose the name Starbucks in honor of Starbuck, the coffee-loving first mate in Herman Melville's *Moby Dick*(so company legend has it), and because they thought the name evoked the romance of the high seas and the seafaring tradition of the early coffee traders. The new company's logo, designed by an artist friend, was a two-tailed mermaid encircled by the store's name.

The inspiration for the Starbucks enterprise was a Dutch immigrant, Alfred Peet, who had begun importing fine arabica coffees into the United States during the 1950s. Peet viewed coffee as a fine winemaker views grapes, appraising it in terms of country of origin, estates, and harvests. Peet had opened a small store, Peet's Coffee and Tea, in Berkeley, California, in 1966 and had cultivated a loyal clientele. Peet's store specialized in importing fine coffees and teas, dark-roasting its own beans the European way to bring out their full flavor, and teaching customers how to grind the beans and make freshly brewed coffee at home. Baldwin, Siegel, and Bowker were well acquainted with Peet's expertise, having visited his store on numerous occasions and spent many hours listening to Peet expound on quality coffees and the importance of proper bean-roasting techniques. All three were devoted fans of Peet and his dark-roasted coffees, going so far as to order their personal coffee supplies by mail from Peet's.



The Pikes Place store featured modest, hand-built nautical fixtures. One wall was devoted to whole-bean coffees; another had shelves of coffee products. The store did not offer fresh-brewed coffee by the cup, but samples were sometimes available for tasting. 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." The store was an immediate success, with sales exceeding expectations, partly because of a favorable article in the *Seattle Times*. In the early months, each of the founders traveled to Berkeley to learn more about coffee roasting from their mentor, Alfred Peet, who urged them to keep deepening their knowledge of coffees and teas. For most of the first year, Starbucks ordered its coffee beans from Peet's, but then the partners purchased a used roaster from Holland and set up roasting operations in a nearby ramshackle building. Baldwin and Bowker experimented with Alfred Peet's roasting procedures and came up with their own blends and flavors. A second Starbucks store was opened in 1972.

By the early 1980s, the company had four Starbucks stores in the Seattle area and could boast of having been profitable every year since opening its doors. But the roles and responsibilities of the cofounders underwent change. 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 he was launching (the Redhook Ale Brewery).

Howard Schultz Enters the Picture

In 1981, Howard Schultz, vice president and general manager of U.S. operations for Hammarplast—a Swedish maker of stylish kitchen equipment and housewares—noticed that Starbucks was placing larger orders than Macy's was for a certain type of drip coffeemaker. Curious to learn what was going on, he decided to pay the company a visit. The morning after his arrival in Seattle, Schultz was escorted to the Pikes Place store by Linda Grossman, the retail merchandising manager for Starbucks. A solo violinist was playing Mozart at the door, with his violin case open for donations. Schultz immediately was taken by the powerful and pleasing aroma of the coffees, the wall displaying coffee beans, and the rows of red, yellow, and black Hammarplast 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 the freshly brewed coffee. After three sips, Schultz was hooked. He began asking the clerk and Grossman questions about the company, about coffees from different parts of the world, and about the different ways of roasting coffee.

Next, Schultz met with Jerry Baldwin and Gordon Bowker, whose offices overlooked the company's coffee-roasting operation. The atmosphere was informal. Baldwin, dressed in a sweater and tie, showed Schultz some new beans that had just come in from Java and suggested they try a sample. Baldwin did the brewing himself, using a glass pot called a French press. Bowker, a slender, bearded man with dark hair and intense brown eyes, appeared at the door and the three men sat down to talk about Starbucks. Schultz was struck by their knowledge of coffee, their commitment to providing high-quality products, 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." Starbucks 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 burn when subjected to dark roasting. He also noted that the makers of supermarket blends prefer lighter roasts because they allow higher yields (the longer a coffee is roasted, the more weight it loses).

Schultz was struck by the business philosophy of the two partners. It was clear from their discussions that Starbucks stood not just for good coffee, but rather 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, rather than just kowtowing to mass-market appeal. The company depended mainly on word-of-mouth to get more people into its stores, then relied on the caliber of its product to give patrons a sense of discovery and excitement. It built customer loyalty cup by cup as buyers of its products developed their palates.

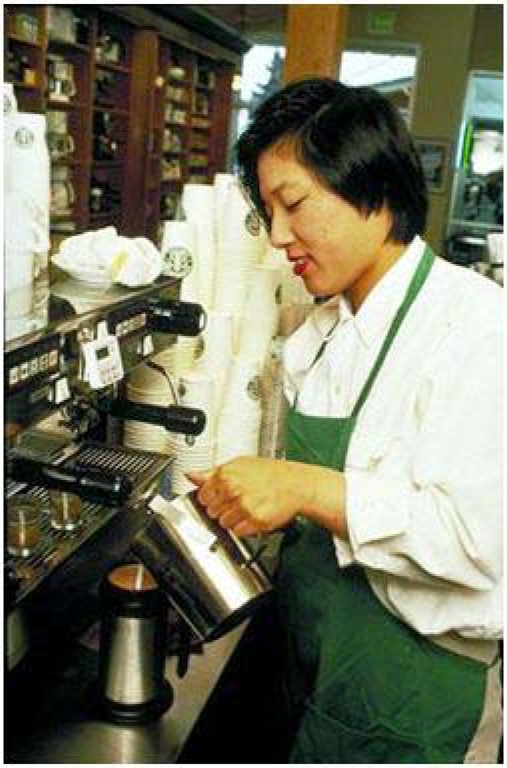
On his trip back to New York the next day, Howard Schultz could not stop thinking about Starbucks and what it would be like to be a part of the Starbucks enterprise. Schultz recalled, "There was something magic about it, a passion and authenticity I had never experienced in business." Living in the Seattle area also had a strong appeal. By the time Schultz landed at Kennedy Airport, he knew he wanted to go to work for Starbucks. Though there was nothing in his background that prepared him for the experience, Schultz asked Baldwin at the first opportunity whether there was any way he could fit into Starbucks. The two quickly established an easy, comfortable rapport, but it still took a year of numerous meetings and a lot of convincing to get Baldwin, Bowker, and their silent partner from San Francisco to agree to hire Howard Schultz. Schultz pursued a job at Starbucks far more vigorously than Starbucks pursued him. There was some nervousness at Starbucks 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—arguing there had to be more than just a few thousand coffee lovers in Seattle who would like the company's products. Schultz believed that Starbucks had such great promise that he offered to take a salary cut in exchange for a small equity stake in the business.

But the owners worried that by offering Schultz a job as head of marketing they would be committing themselves to a new direction for Starbucks. At a spring 1982 meeting with the three owners in San Francisco, Schultz once again presented his vision for opening Starbucks stores across the United States and Canada. He flew back to New York thinking a job offer was in the bag. But the next day Baldwin called Schultz and indicated that the owners had decided against hiring him because geographic expansion was too risky and because they did not share Schultz's vision for Starbucks. Schultz was despondent; still, he believed so deeply in Starbucks' potential that he decided to make a last-ditch appeal. He called Baldwin back the next day and made an impassioned, though 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 on his new responsibilities at Starbucks.

Schultz comes from humble beginnings - his father, Fred, drifted through jobs as a taxi driver, factory worker and truck driver. "He was an uneducated man, a war veteran, and unfortunately he never quite got his piece of the American dream. I've always wanted to try to build the kind of company my father never got a chance to work for," Schultz says, citing healthcare benefits and share options for Starbucks' part-time workers - although he has faced criticism for discouraging US unions on the grounds that they are "unnecessary".

Starbucks and Howard Schultz: The 1982–85 Period

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 educating himself about the retail aspects of the coffee business. By December, Jerry Baldwin decided that Schultz was ready for the final part of his training—roasting coffee. Schultz spent a week at the roaster examining the color of the beans, listening for the telltale second pop of the beans during the roasting process,



learning to taste the subtle differences among Baldwin and Bowker's various roasts, and familiarizing himself with the roasting techniques for different beans.

Meanwhile, he made a point of acclimating himself to the informal dress code, blending in with the culture, and gaining credibility and building trust with colleagues. Making the transition from the high-energy, coat-and-tie style of New York to the more casual ambience of the Pacific Northwest required a conscious effort on Schultz's part. One day during the busy Christmas season that first year, Schultz made real headway in gaining the acceptance and respect of company personnel at the Pikes Place store. The store was packed and Schultz was behind the counter ringing up sales when someone shouted that a customer had just headed out the door with some stuff—two expensive coffeemakers it turned out, one in each hand. Without thinking, Schultz leaped over the counter and chased the thief up the cobblestone street outside the store, yelling "Drop that stuff! Drop it!" The thief was startled enough to drop both pieces and run away. Schultz picked up the merchandise and returned to the store, holding up the coffeemakers 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."

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. Schultz worked with store employees on developing customer-friendly sales skills and produced brochures that made it easy for customers to learn about fine coffees.

Schultz's biggest idea 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, Schultz spotted an espresso bar and went inside to look around. The cashier beside the door nodded and smiled. The *barista* (counter worker) greeted Howard cheerfully, then gracefully pulled a shot of espresso for one customer and handcrafted a foamy cappuccino for another, all the while conversing merrily with those standing at the counter. Schultz judged the barista's performance as "great theater." Just down the way on a side street, he entered an even more crowded espresso bar, where the barista, whom 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. When the trade show concluded for the day, Schultz walked the streets of Milan exploring espresso bars. Some were stylish and upscale; others attracted a blue-collar clientele. What struck Schultz was how popular and vibrant the Italian coffee bars were. Most had few chairs, and it was common for Italian opera to be playing in the background. Energy levels were typically high, and the bars seemed to function as an integral community gathering place. Each one had its own unique character, but they all had a barista who performed with flair and exhibited a camaraderie with the customers. 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. His mind started churning.

Schultz's first few days in Milan produced a revelation: The Starbucks stores in Seattle completely missed the point. Starbucks, he decided, needed to serve fresh-brewed coffee, espresso, and cappuccino in its stores (in addition to beans and coffee equipment). Going to Starbucks should be an experience, a special treat; the stores should be a place to meet friends and visit. Re-creating the Italian coffee-bar culture in the United States could be Starbucks' differentiating factor. Schultz remained in Milan for a week, exploring coffee bars and learning as much as he could about the Italian passion for coffee drinks. In one bar, he heard a customer order a *caffè latte* and decided to try one himself—the barista made a shot of espresso, steamed a frothy pitcher of milk, poured the two together in a cup, and put a dollop of foam on the top. Schultz concluded that it was "the perfect drink," and thought to himself, "No one in America knows about this. I've got to take it back with me."

Schultz's Growing Frustration

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, Schultz encountered strong resistance. Baldwin and Bowker argued that Starbucks was a retailer, not a restaurant or bar. They feared that serving drinks would put them in the beverage business and dilute the integrity of Starbucks' mission as a coffee store. They pointed out that Starbucks was a profitable small, private company and there was no reason to rock the boat. But a more pressing reason for their resistance emerged shortly—Baldwin and Bowker were excited by an opportunity to purchase Peet's Coffee and Tea. The acquisition took place in 1984; 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 their 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's 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, and 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. After Baldwin relented, Starbucks' sixth store, which opened in April 1984, became the first one designed to sell beverages and the first one in downtown Seattle. Schultz asked for a 1,500-square-foot space to set up a full-scale Italian-style espresso bar, but Jerry agreed to allocating only 300 square feet in a corner of the new store. There was no pre-opening marketing blitz and no sign announcing Now Serving Espresso—the lack of fanfare was part of 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; sales at the regular retail counter were only adequate.

Schultz was elated by the test results; his visits to the store indicated that it was becoming a gathering place and that customers were pleased with the beverages being served. Schultz expected that Baldwin's doubts about entering the beverage side of the business would be dispelled and that he would gain approval 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; he believed that espresso drinks were a distraction from the core business of selling fine arabica coffees at retail and 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 two other Starbucks stores.

Over the next several months, Schultz—at the age of 33—made up his mind to leave Starbucks and start his own company. His plan was to open espresso bars in high-traffic downtown locations that would emulate the friendly, energetic atmosphere he had encountered in Italian espresso bars. Schultz had become friends with a corporate lawyer, Scott Greenberg, who helped companies raise venture capital and go public. Greenberg told Schultz he believed investors would be interested in providing venture capital for the kind of company Schultz had in mind. 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

Ironically, as Schultz was finalizing the documents for his new company, Jerry Baldwin announced he would invest $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 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 lead customers to expect something better than competitors offered. Bowker proposed that the new company be named Il Giornale (pronounced *ill jor-nahl-ee*) Coffee Company, a suggestion that Schultz accepted. In December 1985, Bowker and Schultz made a trip to Italy during which 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.

Greenberg and Schultz then drew up plans to raise an initial $400,000 in seed capital and another $1.25 million in equity—enough to launch at least eight espresso bars and prove the concept would work in Seattle and elsewhere. The seed capital was raised by the end of January 1986, primarily from Starbucks and two other investors who believed in Schultz and his ideas, but it took Schultz until the end of the year to raise the remaining $1.25 million. He made presentations to 242 potential investors, 217 of whom said no. Many who heard Schultz's hour-long presentation saw coffee as a commodity business and thought that Schultz's espresso-bar concept lacked any basis for sustainable competitive advantage (no patent on dark roast, no advantage in purchasing coffee beans, no way to bar the entry of imitative competitors). Some noted that 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 still others were turned off by the company's hard-to-pronounce name. 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 continued to display passion and enthusiasm in making his pitch and never doubted that his plan would work. He ended up raising $1.65 million from about 30 investors; most of this money came from nine people, five of whom became directors of the new company.

One of Howard Schultz's earliest moves during the start-up process was to hire Dave Olsen, who in 1974 had opened a coffee bar, Café Allegro, near the busiest entrance to the University of Washington campus. Olsen was a long-standing Starbucks customer, having discovered the quality of Starbucks' coffee beans, gotten to know the owners, and worked with them to develop a custom espresso roast for use in his café. Olsen's successful Café Allegro had become known for *café au lait,* a concoction equivalent to the Italian *caffè latte*. When Olsen heard of Schultz's plans for Il Giornale, he called Schultz and expressed an interest in being part of the new company—he was intrigued by the Italian coffee-bar concept and was looking for a more expansive career opportunity. Olsen not only had coffee expertise but also had spent 10 years in an apron behind the counter at Café Allegro. Schultz immediately picked up on the synergy between him and Olsen. His own strengths were in forming and communicating a vision, raising money, finding good store locations, building a brand name, and planning for growth. Olsen understood the nuts and bolts of operating a retail café, hiring and training baristas, and making and serving good drinks. Plus, Olsen was fun to work with. Schultz put Olsen in charge of store operations, made him the coffee conscience of the company, and gave him the authority to make sure that Il Giornale served the best coffee and espresso possible.

The first Il Giornale store opened in April 1986. It had a mere 700 square feet and was located near the entrance of Seattle's tallest building. The decor was Italian, the menu contained Italian words, and 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 hung from rods on the wall. By closing time on the first day, 300 customers had been served, mostly in the morning hours. Schultz and Olsen worked hard to make sure that all the details were executed perfectly. For the first few weeks, Olsen worked behind the counter during the morning rush.

But while the core idea worked well, it soon became apparent that several aspects of Il Giornale's format weren't appropriate for Seattle. Some customers objected to the incessant opera music, others wanted a place to sit down, and many didn't understand the Italian words on the menu. These "mistakes" were quickly fixed, without compromising the style and elegance of the store. Within six months, Il Giornale was serving more than 1,000 customers a day and regulars had learned how to pronounce the company's name. Because most customers were in a hurry, it became apparent that speedy service was a competitive advantage.

Six months after opening the first store, Il Giornale opened a second store in another downtown building. A third store was opened in Vancouver, British Columbia, in April 1987. Vancouver was chosen to test the transferability of the company's business concept outside Seattle. To reach his goal of opening 50 stores in five years, Schultz needed to dispel his investors' doubts about geographic expansion. By mid-1987 sales at the three stores were 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 and wrestling with the troubles created by the two parts of the company, elected 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."

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. After the papers were signed, Schultz and Scott Greenberg walked across the street to the first Il Giornale store, ordered themselves espresso drinks, and sat at a table near the window. Greenberg placed the hundred-page business plan that had been used to raise the $3.8 million between them and lifted his cup in a toast—"We did it," they said together. 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: 1987–92

The following Monday morning, Schultz returned to the Starbucks offices at the roasting plant, greeted all the familiar faces and accepted their congratulations, then called the staff together for a meeting on the roasting-plant floor. He began:

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."

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 said he believed it was essential, not just an intriguing option, for a company to respect its people, to inspire them, and to share the fruits of its success with those who contributed to its long-term value. 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, however, 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 determined that he would have to make it a priority to build a new relationship of mutual respect between employees and management.

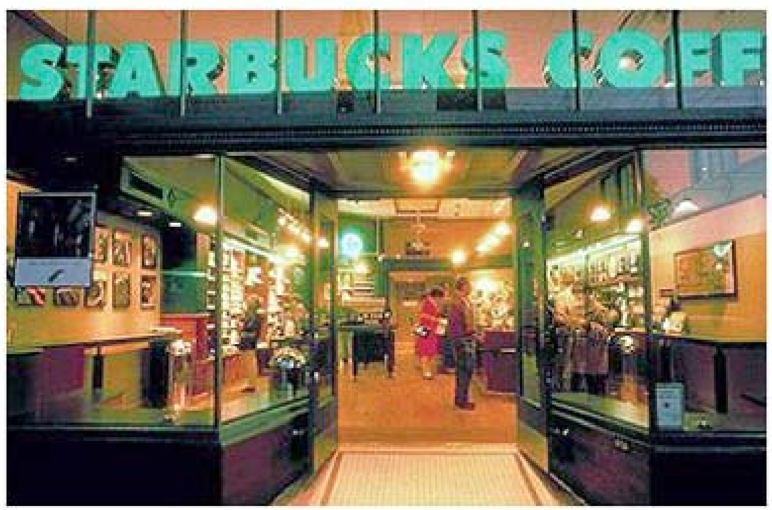
The new Starbucks had a total of nine stores. The business plan Schultz had presented investors called for the new company to open 125 stores in the next five years—15 the first year, 20 the second, 25 the third, 30 the fourth, and 35 the fifth. Revenues were projected to reach $60 million in 1992. But 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 had run a single café for 11 years and was just learning to manage 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 of experience in business and eight years of 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 Starbucks and Il Giornale logos. The Starbucks stores were equipped with espresso machines and remodeled to look more Italian than Old World nautical. The traditional Starbucks brown was replaced by Il Giornale green. 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 format in the 1990s.

By December 1987, employees at Starbucks had begun buying into the changes Schultz was making and trust had begun 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 voted against unionization in 1985, began to question his fellow employees about the need for a union. Over the next few weeks, Moore began a move to decertify the union. He carried a decertification letter around to Starbucks stores and secured the signatures of employees who no longer wished to be represented by the union. After getting a majority of store employees to sign the letter, he presented it to the National Labor Relations Board and the union representing store employees was decertified. Later, in 1992, the union representing Starbucks' roasting plant and warehouse employees was also decertified.

Expansion into Markets Outside the Pacific Northwest

Starbucks' entry into Chicago proved far more troublesome than management anticipated. The first Chicago store opened October 27, 1987, the same day the stock market crashed. Three more stores were opened in Chicago over the next six months, but customer counts were substantially below expectations—Chicagoans didn't take to dark-roasted coffee as fast as Schultz had anticipated. At the first downtown store, for example, which opened onto the street rather than into the lobby of the building where it was located, customers were hesitant to go out in the wind and cold to get a cup of coffee in the winter months. Store margins were squeezed for a number of reasons: It was expensive to supply fresh coffee to the Chicago stores out of the Seattle warehouse, and both rents and wage rates were higher in Chicago than in Seattle. Gradually, customer counts improved, but Starbucks lost money on its Chicago stores until 1990, when prices were raised to reflect higher rents and labor costs, more experienced store managers were hired, and a critical mass of customers caught on to the taste of Starbucks products.



Portland, Oregon, was the next market entered, and Portland coffee drinkers took to Starbucks products quickly. 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—the *Los Angeles Times* named Starbucks as the best coffee in America before the first L.A. store opened. The entry into San Francisco proved more troublesome because of an ordinance there 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.

When Starbucks' store expansion targets proved easier to meet than Schultz had originally anticipated, he upped the numbers to keep challenging the organization. Starting from a base of 11 stores, 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. The opening of 150 new stores in five years significantly exceeded the 1987 business plan's objective of 125.

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, principally by selling shares to new or existing investors, to cover the cost of 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.

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 on down the road. His arguments carried the day with the board and with investors, especially since revenues were growing approximately 80 percent annually and customer traffic at the stores was meeting or exceeding expectations. Starbucks became profitable in 1990 and profits had increased every year thereafter.

Getting into the Mail-Order Business

The original Starbucks had begun a small mail order operation in the 1970s to serve travelers who had visited a Seattle store or former store customers who had moved away from Seattle. Sales were solicited by mailing out a simple brochure. In 1988, Starbucks developed its first catalog and began expanding its mail-order base to targeted demographic groups. In 1990 a toll-free telephone number was set up. Sales grew steadily as the company's name and reputation began to build. The company's market research indicated that its average mail-order customer was a well-educated, relatively affluent, well-traveled connoisseur interested in the arts and cultural events, and usually a loyal buyer of the company's products. As time went on, the cities and neighborhoods in which the company's mail-order customers were located became one of the beacons used to decide where to open new stores.

Moving into the 90s - Schultz's Strategy to Make Starbucks a Great Place to Work

Howard Schultz strongly 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, who eagerly communicated the company's passion for coffee, and who had the skills and personality to deliver consistently pleasing customer service. Many of the baristas were in their 20s and worked part-time, going to college or pursuing other career activities on the side. 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 result in higher levels of performance. Moreover, Schultz wanted to cement the trust that had been building between management and the company's workforce.

One of the requests that employees had made to the prior owners of Starbucks was to extend health care benefits to part-time workers. Their request had been turned down, but Schultz believed that expanding health care coverage to include part-timers was the right thing to do. His father had recently died of 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 care coverage to include part-timers who worked at least 20 hours per week. He saw the proposal not as a generous gesture but as a core strategy to win employee loyalty and commitment to the company's mission. Board members resisted because the company was unprofitable and the added costs of the extended coverage would only worsen the company's bottom line. But Schultz argued passionately, pointing out that if the new benefit reduced turnover, which he believed was likely, then it would reduce the costs of hiring and training—which equaled about $3,000 per new hire. He further pointed out that it cost $1,500 a year to provide an employee with full benefits. Part-timers, he argued, were vital to Starbucks, constituting two-thirds of the company's workforce. Many were baristas who knew the favorite drinks of regular customers; if the barista left, that connection with the customer was broken. Moreover, many part-time employees were called upon to open the stores early, sometimes at 5:30 or 6 am; others had to work until closing—9 pm or later. Providing these employees with health care benefits, he argued, would signal that the company honored their value and contribution.

The board came round and approved Schultz's plan. 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 and, over the years, extended its coverage to include preventive care, crisis counseling, dental care, eye care, mental health care, and treatment for chemical dependency. Coverage was also offered for unmarried partners in a committed relationship. Since most Starbucks employees are young and comparatively healthy, the company has been able to provide broader coverage while keeping monthly payments relatively low.

The value of Starbucks' health care program struck home when one of the company's store managers and a former barista walked into Schultz's office and told him he had AIDS. Schultz said later:

> I had known [Jim] was gay but had no idea he was sick. His disease had entered a new phase, he explained, and he wouldn't be able to work any longer. We sat together and cried, for I could not find meaningful words to console him. I couldn't compose myself. I hugged him.
>
> At that point, Starbucks had no provision for employees with AIDS. We had a policy decision. Because of Jim, we decided to offer health-care coverage to all employees who have terminal illnesses, paying medical costs in full from the time they are not able to work until they are covered by government programs, usually twenty-nine months.
>
> After his visit to me, I spoke with Jim often and visited him at the hospice. Within a year he was gone. I received a letter from his family afterward, telling me how much they appreciated our benefit plan.11

In 1994 Howard Schultz was invited to the White House for a one-on-one meeting with President Clinton to brief him on the Starbucks health care program.

By 1991 the company's profitability had improved to the point where Schultz could pursue another employee program he believed would have a positive long-term effect on the success of Starbucks—a stock option plan for all employees.12 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 every employee companywide stock options in proportion to 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; the value of these first shares was pegged at $6 per share. Each October since then, Starbucks has granted employees options equal to 14 percent of base pay, awarded at the stock price at the start of the fiscal year (October 1). Employees, if they wish, can cash in one-fifth of the shares granted each succeeding year, paying the initial year's price and receiving the current year's price. It took five years for the shares to fully vest. Each of the shares granted in 1991 was worth $132 in October 1996; thus, an employee making $20,000 in 1991 could have cashed in the options granted in 1991 for more than $50,000 in October 1996. In 1991 when the Bean Stock program was presented to employees, Starbucks dropped the term *employee* and began referring to all its people as *partners* because everyone, including part-timers working at least 20 hours per week, was eligible for stock options after six months. At the end of fiscal year 1997, there were 8.7 million shares in outstanding options at an average exercisable price of $19.72 (which compared very favorably to the current stock price of $43.50).

In 1995, Starbucks implemented an employee stock purchase plan called 'The Bean Stock'. Eligible employees could contribute up to 10 percent of their base earnings to quarterly purchases of the company's common stock at 85 percent of the going stock price. The total number of shares that could be issued under the plan was 4 million. After the plan's creation, nearly 200,000 shares were issued; just over 2,500 of the 14,600 eligible employees participated. It was seen as key to retaining good people and building loyalty. Starbucks was able to attract motivated people with above-average skills and good work habits not only because of its fringe benefit program but also because of its pay scale. Store employees were paid $6 to $8 per hour, well above the minimum wage.

Equality was important at Starbucks and employees were referred to as 'partners'. Also, job titles were not capitalized and management often called up stores that performed well to thank the staff. The mission review was also important and this allowed partners to comment on any decision or action of the company relating to how consistent these were the six principles laid out in the company's mission statement.

Starbucks also took great care in recruiting and selecting and retaining its employees and developed human resource management policies that reflected its commitment to its employees. There was a realization that frontline staff and baristas were central in creating 'The Starbucks Experience' which differentiated it from its competitors. Starbucks recruitment motto was 'To have the right people hiring the right people'. Starbucks hired people for adaptability, reliability and ability to work well in a team. The company highlighted the qualities it was looking for in its recruitment advertising which allowed for a certain amount of self selecting on the part of prospective employees.

Starbucks also invested in training its staff and was one of the few retail companies to invest considerably in employee training for all types of employees (including part timers). All selected candidates had to undergo 24 hours of intensive training in one of their regional training centres. This training programme called 'First Impressions' in the US had s standardized curriculum prepared by experts and was delivered by experienced store managers, specialists in various fields and training experts. The aim of this programme was to indoctrinate employees into the company's philosophy and train them in its service principles.

The training programme covered the basics of retail business, coffee making skills, customer service. Some of the elements of the training course included the history of coffee making, using the register, accurate weighing of coffee beans, preparing beverages to customer requirements. There were also rules to be memorized in terms of preparing the coffee such as temperature of the milk. Employees were taught the three basic Star Skills which governed interpersonal relations at Starbucks:

- Maintain and enhance self-esteem
- Listen and acknowledge
- Ask for help

Training for management trainees lasted between 8-12 weeks. Management training included store operations, standard operating procedures, information systems, basics of management, diversity training etc. This was on top of the training which frontline staff received. Sometimes, management staff were required to work in a store for a while to gain a better understanding of coffee making and serving, The company funded outside training programmes where appropriate.

The comnay showed its interest in employee wellness through its development programmes such as ‘Working Solutions’ (which assisted employees with childcare and care for elderly relatives) and ’Partner Connections’ which linked staff with similar interest from across the whole organization (such as parenting and volunteerism).Other benefits included a 30% discount on Starbucks products and merchandise

Starbucks believed that its efforts to make the company an attractive, caring place to work were responsible for its relatively low turnover rates. Whereas most national retailers and fast-food chains had turnover rates for store employees ranging from 150 to 400 percent a year, the turnover rates for Starbucks’ baristas ran about 65 percent. Starbucks’ turnover for store managers was about 25 percent compared to about 50 percent for other chain retailers. There was evidence that Schultz’s approaches, values, and principles were affecting company performance in the intended manner. One Starbucks store manager commented, "Morale is very high in my store among the staff. I’ve worked for a lot of companies, but I’ve never seen this level of respect. It’s a company that’s very true to its workers, and it shows. Our customers always comment that we’re happy and having fun. In fact, a lot of people ask if they can work here.

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. Changes were made based on employees’ comments.

To make sure the company lived up to the elements of the mission statement, a "Mission Review" system was formed. Employees were urged to report their concerns to the company’s Mission Review team if they thought particular management decisions were not supportive of the company’s mission statement. Comment cards were given to each newly hired employee and were kept available in common areas with other employee forms. Employees had the option of signing the comment cards or not. Hundreds of cards were submitted to the Mission Review team each year. The company promised that a relevant manager would respond to all signed cards within two weeks. Howard Schultz reviewed all the comments, signed and unsigned, every month.

As the company continued to grow, resulting in a large and geographically scattered workforce, Starbucks assembled a team of people from different regions to go over employee concerns, seek solutions, and provide a report at the company’s Open Forums. At these Open Forums, held quarterly in every geographic region where the company did business, senior managers met with all interested employees to present updates on Starbucks’ performance, answer questions, and give employees an opportunity to air grievances.

Values and Principles

During these early building years, Howard Schultz and other Starbucks senior executives worked to instill some key values and guiding principles into the Starbucks culture. The keystone value in the effort "to build a company with soul" was that the company would never stop pursuing the perfect cup of coffee. Schultz remained steadfastly opposed to franchising, so that the company could control the quality of its products and build a culture common to all stores. He was adamant about not selling artificially flavored coffee beans—"We will not pollute our high-quality beans with chemicals"; if a customer wanted hazelnut-flavored coffee, Starbucks would provide it by adding hazelnut syrup to the drink rather than by adding hazelnut flavoring to the beans during roasting. Running flavored beans through the grinders would leave chemical residues that would alter the flavor of beans ground afterward; plus, the chemical smell given off by artificially flavored beans would be absorbed by other beans in the store. Furthermore, Schultz didn't want the company to pursue supermarket sales because pouring Starbucks' beans into clear plastic bins, where they could get stale, would compromise the company's distinctive product: fresh, dark-roasted, full-flavored coffee.

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

A values and principles crisis arose at Starbucks in 1989 when customers started requesting nonfat milk in cappuccinos and lattès. Howard Schultz, who read all customer comment cards, and Dave Olsen, head of coffee quality, conducted taste tests of lattès and cappuccinos made with nonfat and skim milk and concluded they were not as good as those made with whole milk. Howard Behar, recently hired as head of retail store operations, indicated that management's opinions didn't matter; what mattered was giving customers what they wanted. Schultz responded, "We will never offer nonfat milk. It's not who we are." Behar stuck to his guns, maintaining that use of nonfat milk should at least be tested—otherwise, all the statements management had made about the importance of really and truly pleasing customers were a sham. A fierce internal debate ensued. One dogmatic defender of the quality and taste of Starbucks' coffee products buttonholed Behar outside his office and told him that using nonfat milk amounted to "bastardizing" the company's products. Numerous store managers maintained that offering two kinds of milk was operationally impractical. Schultz found himself torn between the company's commitment to quality and its goal of pleasing customers. One day after visiting one of the stores in a residential neighborhood and watching a customer leave and go to a competitor's store because Starbucks did not make lattès with nonfat milk, Schultz authorized Behar to begin testing.14 Within six months all 30 stores were offering drinks made with nonfat milk. In 1997, about half the lattès and cappuccinos Starbucks sold were made with nonfat milk.

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. He had a vivid recollection of his father's employment experience—bouncing from one low-paying job to another, working for employers who offered few or no benefits and who conducted their business with no respect for the contributions of the workforce—and he vowed that he would never let Starbucks employees suffer a similar fate, saying:

> My father worked hard all his life and he had little to show for it. He was a beaten man. This is not the American dream. The worker on our plant floor is contributing great value to the company; if he or she has low self-worth, that will have an effect on the company.15

The company's employee benefits program was predicated on the belief that better benefits attract good people and keep them longer. Schultz's rationale was that if you treat your employees well, they will treat your customers well.

Starbucks Becomes a Public Company

Starbucks' initial public offering (IPO) of common stock in June 1992 turned into one of the most successful IPOs of the year. With the capital afforded it by being a public company, Starbucks accelerated the expansion of its store network. Starbucks' success helped specialty coffee products begin to catch on across the United States. Competitors, some imitating the Starbucks model, began to springup in many locations.

The Store Expansion Strategy

In 1992 and 1993 Starbucks developed a three-year geographic expansion strategy that targeted areas which not only had favorable demographic profiles but which 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 stores blanketed the hub, then additional stores were opened in smaller, surrounding "spoke" areas in the region. To oversee the expansion process, Starbucks created zone vice presidents to direct the development of each region and to implant the Starbucks culture in the newly opened stores. All of the new zone vice presidents Starbucks recruited came with extensive operating and marketing experience in chain-store retailing.

Starbucks' store launches grew steadily more successful. In 1995, new stores generated an average of $700,000 in revenue in their first year, far more than the average of $427,000 in 1990. This was partly due to the growing reputation of the Starbucks brand. In more and more instances, Starbucks' reputation reached new markets even before stores opened. Moreover, existing stores continued to post year-to-year gains in sales.

Starbucks had notable success in identifying top retailing sites for its stores. The company had the best real estate team in the coffee-bar industry and a sophisticated system that enabled it to identify not only the most attractive individual city blocks but also the exact store location that was best. The company's site location track record was so good that as of 1997 it had closed only 2 of the 1,500 sites it had opened.

Real Estate, Store Design, Store Planning, and Construction

Schultz formed a headquarters group to create a store development process based on a six-month opening schedule. Starting in 1991, the company began to create 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 and build its own freestanding structures like McDonald's or Wal-Mart did; rather, each space was leased in an existing structure and thus each store differed 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, or busy neighborhood shopping areas convenient to pedestrian foot traffic. Only a select few were in suburban malls. While similar materials and furnishings were used to keep the look consistent and expenses reasonable, no two stores ended up being exactly alike.

In 1994, Starbucks began to experiment with a broader range of store formats. Special seating areas were added to help make Starbucks a place where customers could meet and chat or simply enjoy a peaceful interlude in their day. Grand Cafés with fireplaces, leather chairs, newspapers, couches, and lots of ambience were created to serve as flagship stores in high-traffic, high-visibility locations. 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.

To better reduce average store-opening costs, which had reached an undesirably high $350,000 in 1995, 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. And the whole store layout was developed on a computer, with software that allowed the costs to be estimated as the design evolved. All this cut store-opening costs significantly and reduced store development time from 24 to 18 weeks.

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. Schultz and Olsen met with the team early on to present their vision for what a Starbucks store should be like—"an authentic coffee experience that conveyed the artistry of espresso making, a place to think and imagine, a spot where people could gather and talk over a great cup of coffee, a comforting refuge that provided a sense of community, a third place for people to congregate beyond work or the home, a place that welcomed people and rewarded them for coming, and a layout that could accommodate both fast service and quiet moments." The team researched the art and literature of coffee throughout the ages, studied coffee-growing and coffee-making techniques, and looked at how Starbucks stores had already evolved in terms of design, logos, colors, and mood. The team came up with four store designs—one for each of the four stages of coffee making: 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 the four templates. The company also introduced two ministore formats using the same styles and finishes: the *brevebar*, a store-within-a-store for supermarkets or office-building lobbies, and the *doppio*, a self-contained 8-square-foot space that could be moved from spot to spot. Management believed the project accomplished three objectives: better store designs, lower store-opening costs (about $315,000 per store on average), and formats that allowed sales in locations Starbucks could otherwise not consider

Product Line

Starbucks stores offered a choice of regular or decaffeinated coffee beverages, a special "coffee of the day," and a broad selection of Italian-style espresso drinks. In addition, customers could choose from a wide selection of fresh-roasted whole-bean coffees (which could be ground on the premises and carried home in distinctive packages), a selection of fresh pastries and other food items, sodas, juices, teas, and coffee-related hardware and equipment. In 1997, the company introduced its Starbucks Barista home espresso machine featuring a new portafilter system that accommodated both ground coffee and Starbucks' new ready-to-use espresso pods. Power Frappuccino—a version of the company's popular Frappuccino blended beverage, packed with protein, carbohydrates, and vitamins—was tested in several markets during 1997; another promising new product being tested for possible rollout in 1998 was Chai Tea Lattè, a combination of black tea, exotic spices, honey, and milk.

The company's retail sales mix was roughly 61 percent coffee beverages, 15 percent whole-bean coffees, 16 percent food items, and 8 percent coffee-related products and equipment. 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, coffee-making 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 coffees, and a few hardware items.

In recent years, the company began selling special jazz and blues CDs, which in some cases were special compilations that had been put together for Starbucks to use as store background music. The idea for selling the CDs originated with a Starbucks store manager who had worked in the music industry and selected the new "tape of the month" Starbucks played as background in its stores. He 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 music tapes. Research that involved looking through two years of comment cards turned up hundreds asking Starbucks to sell the music it played in its stores. The Starbucks CDs, created from the Capitol Records library, proved a significant addition to the company's product line. Some of the CDs were specifically collections designed to tie in with new blends of coffee that the company was promoting. Starbucks also sold Oprah's Book Club selections, the profits of which were donated to a literacy fund supported by the Starbucks Foundation.

The company was constantly engaged in efforts to develop new ideas, new products, and new experiences for customers that belonged exclusively to Starbucks. Schultz and other senior executives drummed in the importance of always being open to re-inventing the Starbucks experience.

Store Ambience

Starbucks management looked upon each store as a billboard for the company and as a contributor to building the company's brand and image. Each detail was scrutinized to enhance the mood and ambience of the store, to make sure everything signaled "best of class" and that it reflected the personality of the community and the neighborhood. The thesis was "Everything matters." The company went to great lengths to make sure the store fixtures, the merchandise displays, the colors, the artwork, the banners, the music, and the aromas all blended to create a consistent, inviting, stimulating environment that evoked the romance of coffee, that signaled the company's passion for coffee, and that rewarded customers with ceremony, stories, and surprise. Starbucks was recognized for its sensitivity to neighborhood conservation with the Scenic America's award for excellent design and "sensitive reuse of spaces within cities."

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 customers would smell coffee only. Colorful banners and posters were used to keep the look of Starbucks stores fresh and in keeping with seasons and holidays. Company designers came up with artwork for commuter mugs and T-shirts in different cities that was 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).

To make sure that Starbucks' stores measured up to standards, the company used "mystery shoppers" who posed as customers and rated each location on a number of criteria.

Building a Top Management Team

Schultz continued to strengthen Starbucks' top management team, hiring people with extensive experience in managing and expanding retail chains. Orin Smith, who had an MBA from Harvard and 13 years' experience at Deloitte and Touche, was brought in as chief financial officer in 1990 and then was promoted to president and chief operating officer in 1994. The four key executives during the company's formative years—Howard Schultz, Dave Olsen, Howard Behar, and Orin Smith—contributed the most to defining and shaping the company's values, principles, and culture. As the company grew, additional executives were added in marketing, store supervision, specialty sales, human resources, finance, and information systems. Schultz also took care to add people to Starbucks' board of directors who had experience growing a retail chain and who could add valuable perspectives.

Employee Training

Accommodating fast growth also meant putting in systems to recruit, hire, and train baristas and store managers. Starbucks' vice president for human resources used some simple guidelines in screening candidates for new positions: "We want passionate people who love coffee . . . We're looking for a diverse workforce, which reflects our community. We want people who enjoy what they're doing and for whom work is an extension of themselves."16 Some 80 percent of Starbucks employees were white, 85 percent had some education beyond high school, and the average age was 26.

Every partner/barista hired for a retail job in a Starbucks store received at least 24 hours training in the first two to four weeks. The training 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 were trained in using the cash register, weighing beans, opening the bag properly, capturing the beans without spilling them on the floor, holding the bag in a way that keeps air from being trapped inside, and affixing labels on the package exactly one-half inch over the Starbucks logo. Beverage preparation occupied even more training time, involving such activities as 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 make drinks to customer specifications. There were sessions on how to clean the milk wand on the espresso machine, explain the Italian drink names to customers, sell an $875 home espresso machine, make eye contact with customers, and take personal responsibility for the cleanliness of the coffee bins. Everyone was drilled in the Star Skills, three guidelines for on-the-job interpersonal relations: (1) maintain and enhance self-esteem, (2) listen and acknowledge, and (3) ask for help. 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; customers who order one pound of beans must be given exactly that—not .995 pounds or 1.1 pounds; never let coffee sit in the pot more than 20 minutes; always compensate dissatisfied customers with a Starbucks coupon that entitles them to a free drink.

Management trainees attended classes for 8 to 12 weeks. Their training went much deeper, covering not only the information imparted to baristas but also the details of store operations, practices and procedures as set forth in the company's operating manual, information systems, and the basics of managing people. 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 impart their knowledge about coffee and their passion about Starbucks.

Each time Starbucks opened stores in a new market, it undertook a major recruiting effort. Eight to 10 weeks before opening, the company placed ads to hire baristas and begin their training. It sent a Star team of experienced managers and baristas from existing stores 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.

Product Supply

Dave Olsen, Starbucks' senior vice president for coffee, personally spearheaded Starbucks' efforts to secure top-notch coffee beans to supply the company's growing needs. He traveled regularly to coffee-producing countries—Colombia, Sumatra, Yemen, Antigua, Indonesia, Guatemala, New Guinea, Costa Rica, Sulawesi, Papua New Guinea, Kenya, Ethiopia, Java—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. Reporting to Olsen was a group that created and tested new blends of beans from different sources.

Although most coffee was purchased in the commodity market—coffee was the world's second largest traded commodity—coffee of the quality sought by Starbucks was usually purchased on a negotiated basis at a substantial premium above commodity coffees, depending on supply and demand at the time of purchase. Coffee prices were subject to considerable volatility due to weather, economic, and political conditions in the growing countries, as well as agreements establishing export quotas or efforts on the part of the International Coffee Organization and the Association of Coffee Producing Countries to restrict coffee supplies.

Starbucks entered into fixed-price purchase commitments in order to secure an adequate supply of quality green coffee beans and to limit its exposure to fluctuating coffee prices in upcoming periods. When satisfactory fixed-price commitments were not available, the company purchased coffee futures contracts to provide price protection. Nonetheless, there had been occasions in years past when unexpected jumps in coffee prices had put a squeeze on the company's margins and necessitated an increase in the prices of its beverages and beans sold at retail.

Roasting Coffee Beans

Starbucks considered the roasting of its coffee beans to be an art form. Each batch was roasted in a powerful gas oven for 12 to 15 minutes. Highly trained and experienced roasting personnel monitored the process, using both smell and hearing, to judge 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.

On a daily basis, when he wasn't traveling in search of coffee supplies, Dave Olsen checked coffee samples from the roasting process, sniffing the aromas, tasting sample cups, and recording his observations in a logbook.

In 1998, Starbucks had three roasting plants. The company's smallest plant, built in 1989 and originally thought to be big enough to supply the company's needs for the next 10 years, was dedicated to supplying the company's mail-order business. In 1993, a 305,000-square-foot plant was opened in Kent, Washington, just south of Seattle; its output mainly was being used to supply stores west of the Mississippi. In 1994, the company began construction of an $11 million roasting facility in York, Pennsylvania, that could be expanded to 1 million square feet to supply stores east of the Mississippi.

Bonding with Customers

About 5 million customers per week were patronizing Starbucks stores in early 1998. Stores did about half of their business by 11 am. Loyal customers patronized a Starbucks store 15 to 20 times a month, spending perhaps $50 monthly. Some customers were Starbucks fanatics, coming in daily. Baristas became familiar with regular customers, learning their names and their favorite drinks. Christine Nagy, a field director for Oracle Corporation in Palo Alto, California, told a *Wall Street Journal* reporter, "For me, it's a daily necessity or I start getting withdrawals."17 Her standard order was a custom drink: a decaf grande nonfat no-whip no-foam extra-cocoa mocha; when the baristas saw her come through the door, she told the reporter, "They just [said,] 'We need a Christine here.'"

Mail Order Sales

Starbucks published a mail-order catalog that was distributed six times a year and that offered coffee, candies and pastries, and select coffee-making equipment and accessories. A special business gift-giving catalog was mailed to business accounts during the 1997 Christmas holiday season. The company also had an electronic store on the Internet. In 1997, sales of this division were about $21.2 million, roughly 2 percent of total revenues; almost 50,000 mail-order customers were signed up to receive monthly deliveries of Starbucks coffee as of late 1997. Starbucks management believed that its direct-response marketing effort helped pave the way for retail expansion into new markets and reinforced brand recognition in existing markets.

Joint Ventures

In 1994, after months of meetings and experimentation, PepsiCo and Starbucks entered into a joint venture arrangement to create new coffee-related products for mass distribution through Pepsi channels, including cold coffee drinks in a bottle or can. Howard Schultz saw this as a major paradigm shift with the potential to cause Starbucks business to evolve in heretofore unimaginable directions; he thought it was time to look for ways to move Starbucks out into more mainstream markets. Cold coffee products had generally met with very poor market reception, except in Japan, where there was an $8 billion market for ready-to-drink coffee-based beverages. Nonetheless, Schultz was hoping the partners would hit on a new product to exploit a good-tasting coffee extract that had been developed by Starbucks' recently appointed director of research and development. The joint venture's first new product, Mazagran, a lightly flavored carbonated coffee drink, was a failure; when test- marketed in southern California, some consumers liked it and some hated it. While people were willing to try it the first time, partly because the Starbucks name was on the label, repeat sales proved disappointing. Despite the clash of cultures and the different motivations of the two partners, the partnership held together because of the good working relationship that evolved between Howard Schultz and Pepsi's senior executives. Then Schultz, at a meeting to discuss the future of Mazagran, suggested, "Why not develop a bottled version of Frappuccino?"18 Starbucks had come up with the new cold coffee drink it called Frappuccino in the summer of 1995, and it had proved to be 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; the response was overwhelming, with sales running 10 times over projections and 70 percent repeat business. In September 1996, the partnership invested in three bottling facilities to make Frappuccino, with plans to begin wider distribution. Sales of Frappuccino reached $125 million in 1997 and achieved national supermarket penetration of 80 percent. Sales were projected to reach $500 million in 1998; Starbucks management believed that the market for Frappuccino would ultimately exceed $1 billion.

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. The new line, featuring such flavors as Dark Roast Espresso Swirl, JavaChip, Vanilla MochaChip, Biscotti Bliss, and Caffe Almond Fudge, hit supermarket shelves in April 1996; by July, Starbucks coffee-flavored ice cream was the top-selling superpremium brand in the coffee segment. In 1997, two new low-fat flavors were added to complement the original six flavors, along with two flavors of ice cream bars; all were well received in the marketplace. Additional new ice cream products were planned for 1998.

Also in 1995, Starbucks worked with Seattle's Redhook Ale Brewery to create Double Black Stout, a stout beer with a shot of Starbucks coffee extract in it.

Licensed Stores and Specialty Sales

In recent years Starbucks had begun entering into a limited number of licensing agreements for store locations in areas where it did not have ability to locate its own outlets. The company had an agreement with Marriott Host International that allowed Host to operate Starbucks retail stores in airport locations, and it had an agreement with Aramark Food and Services to put Starbucks stores on university campuses and other locations operated by Aramark. Starbucks received a license fee and a royalty on sales at these locations and supplied the coffee for resale in the licensed 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 Starbucks managers and store employees.

Starbucks also had a specialty sales group that provided its coffee products to restaurants, airlines, hotels, universities, hospitals, business offices, country clubs, and select retailers. One of the early users of Starbucks coffee was Horizon Airlines, a regional carrier based in Seattle. In 1995, Starbucks entered into negotiations with United Airlines to have Starbucks coffee served on all United flights. There was much internal debate at Starbucks about whether such a move made sense for Starbucks and the possible damage to the integrity of the Starbucks brand if the quality of the coffee served did not measure up. After seven months of negotiation and discussion over coffee-making procedures, United Airlines and Starbucks came up with a way to handle quality control on some 500-plus planes with varying equipment, and Starbucks became the coffee supplier to the 20 million passengers flying United each year.

In addition, Starbucks made arrangements to supply an exclusive coffee blend to Nordstrom's for sale only in Nordstrom stores, to operate coffee bars in Barnes & Noble bookstores, and to offer coffee service at some Wells Fargo Bank locations in California. Most recently, Starbucks began selling its coffees in Chapters, a Toronto book retailer with sites throughout Canada, and in Costco warehouse club stores. A 1997 agreement with U.S. Office Products gave Starbucks the opportunity to provide its coffee to workers in 1.5 million business offices. In fiscal 1997, the specialty sales division generated sales of $117.6 million, equal to 12.2 percent of total revenues.

International Expansion

In markets outside the continental United States (including Hawaii), Starbucks' strategy was to license a reputable and capable local company with retailing know-how in the target host country to develop and operate new Starbucks stores. In some cases, Starbucks was a joint venture partner in the stores outside the continental Untied States. Starbucks created a new subsidiary, Starbucks Coffee International (SCI), to orchestrate overseas expansion and begin to build the Starbucks brand name globally via licensees; Howard Behar was president of SCI.

Going into 1998, SCI had 12 retail stores in Tokyo, 7 in Hawaii, 6 in Singapore, and 1 in the Philippines. Agreements had been signed with licensees to begin opening stores in Taiwan and Korea in 1998. The company and its licensees had plans to open as many as 40 stores in the Pacific Rim by the end of September 1998. The licensee in Taiwan foresaw a potential of 200 stores in that country alone. The potential of locating stores in Europe and Latin America was being explored.

Corporate Responsibility

Howard Schultz's effort to "build a company with soul" included a broad-based program of corporate responsibility, orchestrated mainly through the Starbucks Foundation, set up in 1997. Starbucks was the largest corporate contributor in North America to CARE, a worldwide relief and development organization that sponsored health, education, and humanitarian aid programs in most of the Third World countries where Starbucks purchased its coffee supplies; Starbucks began making annual corporate contributions to CARE when it became profitable in 1991. In addition, CARE samplers of coffee and CARE-related mugs, backpacks, and T-shirts were offered in the company's mail-order catalog; a portion of the price on all sales was donated to CARE. In 1995 Starbucks began a program to improve the conditions of workers in coffee-growing countries, establishing a code of conduct for its growers and providing financial assistance for agricultural improvement projects. In 1997, Starbucks formed an alliance with Appropriate Technology International to help poor, small-scale coffee growers in Guatemala increase their income by improving the quality of their crops and their market access; the company's first-year grant of $75,000 went to fund a new processing facility and set up a loan program for a producer cooperative. Starbucks stores also featured CARE in promotions and had organized concerts with Kenny G and Mary Chapin Carpenter to benefit CARE.

Starbucks had an Environmental Committee that looked for ways to reduce, reuse, and recycle waste, as well as contribute to local community environmental efforts. There was also a Green Team, consisting of store managers from all regions. The company had donated almost $200,000 to literacy improvement efforts, using the profits from store sales of Oprah's Book Club selections. Starbucks stores participated regularly in local charitable projects of one kind or another, donating drinks, books, and proceeds from store-opening benefits. The company's annual report listed nearly 100 community organizations which Starbucks and its employees had supported in 1997 alone. Employees were encouraged to recommend and apply for grants from the Starbucks Foundation to benefit local community literacy organizations.

On the Fourth of July weekend in 1997, three Starbucks employees were murdered in the company's store in the Georgetown area of Washington, D.C. Starbucks offered a $100,000 reward for information leading to the arrest of the murderer(s) and announced it would reopen the store in early 1998 and donate all future net proceeds of that store to a Starbucks Memorial Fund that would make annual grants to local groups working to reduce violence and aid the victims of violent crimes.

Competitors

Going into 1997, there were an estimated 8,000 specialty coffee outlets in the United States. Starbucks' success was prompting a number of ambitious rivals to scale up their expansion plans. Observers believed there was room in the category for two or three national players, maybe more. Starbucks' closest competitor, Second Cup, a Canadian franchisor with stores primarily in Canada, was less than one-third its size; Second Cup owned Gloria Jeans, a franchisor of specialty coffees, with stores located primarily in malls throughout the United States. No other rival had as many as 250 stores, but there were at least 20 small local and regional chains that aspired to grow into rivals of Starbucks, most notably New World Coffee, Coffee People, Coffee Station, Java Centrale, and Caribou Coffee. Observers expected many of the local and regional chains to merge in efforts to get bigger and better position themselves as an alternative to Starbucks. In addition, numerous restaurants were picking up on the growing popularity of specialty coffees and had installed machines to serve espresso, cappuccino, lattè, and other coffee drinks to their customers.

The company also faced competition from nationwide coffee manufacturers such as Kraft General Foods (the parent of Maxwell House), Procter & Gamble (the owner of the Folger's brand), and Nestlé, which distributed their coffees through supermarkets. There were also a number of specialty coffee companies that sold whole-bean coffees in supermarkets. Because many consumers were accustomed to purchasing their coffee supplies at supermarkets, it was easy for them to substitute these products for Starbucks.

Building the Starbucks Brand

So far, Starbucks had spent very 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. The company was, however, engaged in a growing effort to extend the Starbucks brand and penetrate new markets. In addition to expanding internationally, venturing into ice cream with Dreyer's and into Frappuccino with Pepsi, partnering with licensees, and developing specialty and mail-order sales, Starbucks had recently begun selling its coffees in supermarkets.

Supermarket sales were test-marketed in over 500 stores in Chicago in the summer of 1997. Management believed that the tests confirmed the appeal of offering Starbucks coffee to existing customers in convenient supermarket locations while at the same time introducing new customers to its products. Two-thirds of all coffee was sold in supermarkets. In November 1997, Starbucks hired Nestlé veteran, Jim Ailing, as senior vice president of grocery operations to direct Starbucks' supermarket sales effort. The company started rolling out supermarket sales of its coffees in 10 major metropolitan areas in the spring of 1998. Starbucks coffee sold in supermarkets featured distinctive, elegant packaging; prominent positions in grocery aisles; and the same premium quality as that sold in its own stores. Product freshness was guaranteed by Starbucks' FlavorLock packaging, and the price per pound paralleled the prices in Starbucks' retail stores.

The company was also said to be testing "light roast" coffee blends for those customers who found its current offerings too strong. And, in the summer of 1997, Starbucks quietly test-marketed four 20 percent fruit-juice beverages in one market.19 The single-serve bottled drinks were priced around $2, and at least one contained caffeine. Also on the new-product front was an apple cider made exclusively for Starbucks by Nantucket Nectars. Plus, the company was selling chocolate bars and other candy, and had plans to bring candy production in-house if sales went well enough.

Challenges of the Noughties

2000 brought a change of leadership in Starbucks when Schultz resigned from being CEO to take a seat on the board. In 2000 Orin Smith ascended from president to CEO; Schultz stayed on as chairman of the board. During Smith's five-year tenure, Starbucks maintained its mind-blowing growth, but at the same time, it introduced sophisticated testing and R&D and took steps to boost efficiency and sales, like installing automated Verismo espresso machines. By no longer having to scoop and tamp coffee for each shot, baristas could make a drink 40% faster, moving customers through lines more quickly. Drive-throughs became standard, and the company released its first CD. Smith's successor was a Wal-Mart veteran, Jim Donald, who took the company into books, movie promotions and oven-warmed breakfast sandwiches, which added about $35,000 to the average store's $1 million annual sales.

Tensions over what Starbucks was becoming--cluttered, corporate, soulless--were rising within the company even before the Valentine's Day memo. "These were real conversations we were having," says Michelle Gass, head of global strategy. "A lot of last year was figuring out what really matters to our customers."

At the same time, the slowing economy started to dent sales. "They finally got to the point where their customer base was so broad it wasn't recession-proof," says Bear Stearns analyst Joseph Buckley. In recessionary times, the $4 latte became an unaffordable luxury, and Starbucks is competing found itself competing with McDonalds and Dunkin' Donuts, two chains more interested in selling lots of coffee than in being a part of people's lives. The summer of 2007 was particularly bad because of consumers' growing boredom with Frappuccinos, which make up about 15% of sales, according to UBS analyst David Palmer. Then, in the quarter ending in September, traffic at established U.S. stores fell 1%, the first drop ever. The next quarter, traffic dropped again--down 3%--and comp-store sales fell 1%, the first time Starbucks had ever swung negative..

But perhaps most hurtful were the mounting complaints from customers, employees and even Schultz himself that in its pursuit of growth, the company has strayed too far from its roots. As Schultz memorably wrote to the company's top execs on Valentine's Day, 2007, "We have had to make a series of decisions that, in retrospect, have led to the watering down of the Starbucks experience and what some might call the commoditization of our brand." The company that taught us that coffee is not a commodity has itself become one.

Critics are numerous, and among them are the usual anti-corporate arguments, like the ones published on *IHateStarbucks.com*, a dedicated web site for Starbucks haters:

“The vast majority of the coffee is grown using underpaid third world labor”

“Starbucks is spreading across the world like a virus, infecting cultures with their formula of what a coffee shop should be”

“They are everywhere”

“They have predatory business practices. Common practices are things like paying landlords to not renew leases for coffee shops so that they can move in”

“They sell fake corporate responsibility”

“Their coffee is always bitter”

“The gross profit margin per store is, on average, 59.1%, therefore there is plenty of wiggle room for the company to pay more than a dollar a pound for coffee. (read: livable wage for their slave labor)”

“Faux ecologic responsibility””

“False employee benefits. They give part time workers (20 hours per week) health insurance. However, I have received hundreds of emails from employees that consistently receive 19.75. 15 minutes shy of earning those costly benefits”

“What they sell is incredibly unhealthy. Get the nutritional information, from their website it is appalling. The Caramel Pecan Sticky Roll (which has more fat than a Big Mac) or even better (worse), the Eggnog Lattes are so bad for you it is astounding”

The Noughties brought HR challenges also as well as this bad press. Working at Starbucks began to lose its charm as the company grew bigger and there were complaints that the company didn’t care about its employees and was merely playing lip service in this regard. Employees were not paid for work related injuries such as repetitive stress and spilling hot beverages on themselves. It was also said that the company came down hard on union activity and that employees involved in forming unions often lost their jobs. The company was of the view that as it provided for the needs of employees that there should be no need for employees to organize externally.

Flexible working was introduced in 2000 and flexible benefits (referred to as ‘Your Special Blend’) were also introduced in contrast to the ‘one size fits all’ approach of competitors. Employee surveys were also undertaken on the benefits package to see if it was meeting employee needs.

On Jan. 7, the board reinstated Schultz as CEO to revive the coffee empire. "It's a time for reinvention, and there's no one better to do it than Howard," said Howard Behar, who ran Starbucks' international operations throughout the late 1990s and as a board member voted to reinstall Schultz. The stock rallied 8%, and baristas went wild. "Woooohooooo!" read two posts on StarbucksGossip.com "Welcome back, Howie!!! All of Starbucks missed you, and we can't wait to see where you take us,". More than a few posts skeptically pointed out that Schultz had never gone far (his office was next to Donald's), but overall the tone was jubilant.

Schultz is no less messianic. "I came back because it's personal," he says. "I came back because I love this company and our people and feel a deep sense of responsibility to 200,000 people and their families." On the afternoon of Jan. 7, he gathered the 4,000-some people who work at Starbucks headquarters. "I said, 'We need everyone in this room to believe in the mission of the company, and if you don't, there's nothing wrong, but you shouldn't be here,'" Schultz recalls.

And it's not just Schultz who came back. It was as if he were reassembling the band: Roberts, the merchandising guru; Wanda Herndon, who left in 2006 but returned to run global communications; and Arthur Rubinfeld, the company's first vice president for store development, who has known Schultz since the two were in their 20s. Schultz holed up with them and others he'd promoted from within at the Palace Ballroom in downtown Seattle for three days of 14-hour strategy sessions. The retreat started by listening to Beatles music and talking about how great icons reinvent themselves.

Schultz moved swiftly. On Jan. 30, he announced that Starbucks would close 100 underperforming stores and curtail U.S. store openings to about 1,175 in 2008, down 34% from the prior year. The breakfast sandwiches were toast in North America. To get focused on the long term, it would stop reporting comp-store sales to Wall Street. Then, at the March 19 annual meeting, the company laid out its initiatives to reinvigorate the "coffee experience." Some of the projects had been kicked around, but with Schultz back in the CEO chair, everything started to get done more rapidly. "The rate at which we're making these moves is far and away faster than anything I've experienced the last few years," says COO Martin Coles.

"We are doing everything we can to differentiate Starbucks from everyone else that is attempting to be in the coffee business," Schultz said at the company's annual meeting in March 2008, alluding to McDonald's, Dunkin' Donuts and several convenience-store chains that have been making a run at Starbucks' customers. Starbucks will once again grind beans in its stores for drip coffee. It will give free drip refills, offer latte upgrades and provide two hours of wi-fi to anyone with a registered Starbucks stored-value card. The company also began rolling out its new armor: a sleek, low-rise espresso machine that makes baristas more visible and gives them more control over the process. It has launched MyStarbucksIdea.com for consumers to talk to one another and the company. "This," said Schultz, "is just the beginning."

According to Schultz, he came back into an operational role because he felt that the way out of crisis was not a simple change in business strategy, but instead– in his words– “love and nurturing.” His key to turning things around was revitalizing the investment in his people, recommitting to the core purpose of the organization and providing employees with hope and inspiration.

He noted the transformation of Starbucks since this revitalization has been key to a tremendous amount of new innovation happening inside the company. People commented to him that it reminded them of what the early days at Starbucks must have been like.

Schultz took 10,000 of his best people and brought them together in New Orleans in late 2008 for a leadership conference where they spent *50,000 volunteer hours* helping communities re-build after Hurricane Katrina. Below is a documentary that was filmed about this event. According to Schultz, this event was one of the most important things that galvanized the culture of Starbucks again– and he made the enormous investment despite opposition from angry shareholders who didn’t understand how the expense of the event would benefit the company.

As for lessons learned about preparing the company for the future, Schultz says that great brands provide an ongoing emotional connection and sense of discovery, and this comes from building the brand from the inside. Which is why, while he has good things to say about his CEO predecessor Jim Donald, he admits that his weakness was not having a successor ready from within the company. According to Schultz, it is a steep challenge for someone from the outside to continue to stay true to the culture and values when things go awry. He does not plan to make this mistake again– his successor at Starbucks will come from within.

Schultz summed up his thoughts about the company culture this way:

When you love something, when you care so much, when you feel the responsibility… you find another gear. There is a word I think of when I think of Starbucks. And it’s love. We love what we have built here. We love the experience we have created for our people. Somehow, along the way, the level of that feeling got somewhat blurred by success. That is one of the things I think will be very apparent in this week about what it means to love something… and then the responsibility that goes with that.