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CASE 17

Starbucks Corporation: The New S-Curves

Despite being a public company for 20 years, Starbucks is in the early days of its growth and development.[1]

—Howard Schultz, chairman and CEO of Starbucks

By the end of fiscal year (FY) 2010, Starbucks' painful, three-year transformation agenda, which included closing more than 900 stores, terminating 18,700 jobs, replacing the senior leadership team, and implementing new Lean store practices to achieve operational excellence, was essentially complete. Starting with the return in 2008 of Starbucks founder and board chairman Howard Schultz as its president and CEO, Starbucks had pulled itself back from the brink of "destruction" after an unsustainable store expansion strategy coupled with a global economic recession had the company's future looking uncertain and its stock losing half its value. Finishing FY2010 with a record $10.7 billion in revenue and a first-ever shareholder dividend, Starbucks began FY2011 poised to celebrate its 40th anniversary by focusing on a new blueprint for growth described by Schultz: "Sourcing, roasting, and serving high-quality coffee will remain our core, but we are also pursuing sustainable, profitable growth with a more diversified, multichannel and multibrand business model."[2]

That growth would be enabled by a new organizational and leadership system supported by lessons the company learned during the transformation. Schultz outlined those lessons at the end of his second book:

Grow with discipline. Balance intuition with rigor. Innovate around the core. Don't embrace the status quo. Find new ways to see. Never expect a silver bullet. Get your hands dirty. Listen with empathy and over communicate with transparency. Tell your story, refusing to let others define you. Use authentic experiences to inspire. Stick to your values, they are your foundation. Hold people accountable but give them the tools to succeed. Make the tough choices; it's how you execute that counts. Be decisive in times of crisis. Be nimble. Find truth in trials and lessons in mistakes. Be responsible for what you see, hear, and do. Believe.[3]

By the end of FY2013, it looked as if the new growth strategy and system were paying off. In the United States, comparable-store sales had risen by 7% or greater in 15 consecutive quarters on the strength of a number of new products and customer service–enhancing innovations such as mobile payments integrated with the company's longstanding gift and loyalty card programs. The evolving Starbucks channel development segment had grown to $1.4 billion, and to boost its business both inside and outside its cafés, the company had acquired three new brands: a premium fresh juice company, a bakery, and a purveyor of premium loose-leaf tea.

Starbucks shares surged by 46% in FY2013, while the Standard & Poor's 500 Index advanced 30% during that time. By Q1 2014, Starbucks stock had reached an all-time high of just over $80—a more than 800% increase over a low of just over $8 during the company's downturn in 2009.

Still the question remained whether the company could consistently maintain this phase of rapid growth in a more disciplined manner than it had pursued during its previous phase of rapid growth, which had ended in financial crisis and a souring of the brand that destroyed material shareholder value. What were the potential risks of another aggressive growth implosion? Could the company pursue so many diverse products and channels without damaging its core coffee business? Had the company created an internal growth system and organizational environment to support this new surge and preserve the differentiating essence of Starbucks?

New Products and Categories

To signal this new era of multichannel, multibrand growth, Starbucks dropped the words "Starbucks Coffee" from its green mermaid logo in 2011. Although single sales of premium coffee and coffee drinks in U.S. bricks-and-mortar retail shops continued to drive the majority of its revenue between 2010 and 2013, the company focused on diversifying its product offerings to appeal to changing preferences, enhancing the customer experience, and expanding

This case was prepared by Katherine Ludwig, Research Associate, under the supervision of Edward D. Hess, Professor and Batten Institute Executive-in-Residence. It was written as a basis for class discussion rather than to illustrate effective or ineffective handling of an administrative situation. Copyright © 2014 by the University of Virginia Darden School Foundation, Charlottesville, VA. All rights reserved. *To order copies, send an e-mail to* sales@dardenbusinesspublishing.com. *No part of this publication may be reproduced, stored in a retrieval system, used in a spreadsheet, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of the Darden School Foundation.*

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internationally. Because approximately half of all sales at Starbucks stores occurred before 11:00 a.m., the company also set its sights on maximizing its global storefronts and stretching its goal to be the third-most-common place to frequent (after work and home) in the morning and during the lunch and evening hours as well.

Super-Premium Juice

One of the company's first moves toward leveraging its core retail competencies with new products and new categories was to go after the $50 billion health and wellness industry. For those consumers looking for options beyond high-calorie lattes, Frappuccinos, and blueberry muffins, Starbucks first began focusing on healthier packaged fare by offering Naked Juice beverages and Kind all-natural snack bars in its coffee stores. Then, in 2011, the company laid out $30 million in cash for Evolution Fresh, Inc., a California-based juicery started by one of the original founders of Naked Juice. It was one of the few remaining juiceries that still cracked, peeled, squeezed, and pressed its own raw fruits and vegetables using an innovative pasteurization process that preserved more nutrients while enabling production scaling.

At the time of the acquisition, many in the media questioned the move into premium juice and wondered whether Starbucks was moving too far from its core business. In one such article, Schultz responded to the skepticism:

Well, you have to ask: What is the core?... We have 40-plus years of acquiring real estate and designing and operating stores all over the world. We understand how to elevate and romanticize an experience built around a beverage. And we think we can do that again on a platform of health and wellness and elevate the nutritious value of what fresh fruit and vegetables can be in a world that is longing for educational tools to eat and live healthier.[4]

Starbucks moved quickly to ramp up the new brand. By the end of FY2012, Starbucks had opened four Evolution Fresh stores, which sold vegan and vegetarian dishes as well as premium fresh juice. It also was selling ready-to-drink Evolution Fresh juice in 2,200 of its Starbucks cafés—replacing the Naked Juice previously sold—as well as in 1,500 supermarkets and other convenience stores. By the end of FY2013, the locations numbered 8,000, and the company had built a new, state-of-the-art juicery in California to quadruple production.

Better food

Pairing food items with its high-quality beverages had long been the bane of Starbucks. Inconsistent quality from outside suppliers did little to boost sales or attract additional customers, and unpleasant aromas often annoyed the coffee purists. Generally, only one in three Starbucks transactions involved food. Food sales improved somewhat during the transformation as a result of efforts by the company to improve quality and offer healthier and more savory fare such as the Starbucks bistro box, which contained such items as hard-boiled eggs, cheese, crackers, vegetables, and fruit. Food items accounted for 19% of revenue in 2010—up from 13% during the downturn.

But food sales remained flat for 2011 and 2012 and only comprised 30% of store transactions during that time, which was why many industry analysts were skeptical to dubious about the company's decision to shell out $100 million in cash in 2012 to acquire Bay Bread, LLC, and its 19-store La Boulange Café & Bakery chain, located in San Francisco. By the end of FY2013, however, La Boulange croissants, sweet and savory pastries, breads, and muffins, all served warm, occupied bakery display cases in 3,500 U.S. Starbucks stores, and overall food sales had increased to 20% of the retail product mix at company-operated stores.

During the earnings call for Q1 2014, Starbucks CFO Troy Alstead stated that food had become a "disproportionate driver" of same-store sales and that the sale of croissants alone had doubled since the La Boulange upgrade. The company planned for the full La Boulange rollout in all U.S. company-operated stores by the end of 2014.[5]

Starbucks was looking for ways to not only improve quality and thus drive sales, but also to reduce costs and continue to boost profits by cutting out the middleman for its packaged food items. According to Daniel Lubetzky, founder of Kind Healthy Snacks, which made the Kind snack bars first sold in Starbucks coffee shops, Starbucks had long been trying to acquire his company or negotiate a deal for a private-label snack bar.[6] Either option would have reduced Starbucks's costs and increased its margins, but Lubetzky refused. As a result, in late summer 2013, Starbucks nixed its relationship with Kind Healthy Snacks and rolled out its own Evolution Harvest fruit-and-nut bars for sale at its cafés as well as nationally at Whole Foods Market.

Also in 2013, Starbucks announced that it had entered into a multiyear strategic agreement with Danone to develop an exclusive line of Evolution Fresh, Inspired by Danone, fresh dairy products, starting with a Greek yogurt parfait to be sold exclusively in Starbucks stores in 2014 and expanded to grocery store distribution in 2015.

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While clearly working to boost same-store sales by increasing its offerings, Starbucks maintained focus on its core morning crowd, so as not to cede market share to other quick-service chains such as McDonald's and Burger King, which were striving to increase breakfast-hour sales. In March 2014, Starbucks launched four new and improved breakfast sandwiches: ham and swiss on a croissant; spinach, sun-dried tomatoes, and cheese on ciabatta; egg and cheddar on toast; and a lower-calorie egg white, bacon, and cheese on an English muffin. To industry analysts, the improved low-calorie breakfast sandwich was a direct response to McDonald's recently launched Egg White Delight McMuffin.[7] Starbucks planned to test similar upgrades to café lunch sandwiches during the summer of 2014.[8]

Shortly after the La Boulange rollout, Starbucks again proved its commitment and responsiveness to its core customer base when, after numerous complaints, it brought back the popular pumpkin and lemon loaves that had been pushed out by the new La Boulange menu.

Another wrinkle of the rollout—long lines and wait times—appeared more ominous, however. Many observers thought the delay was due to the new requirement of having the baristas heat the baked goods before serving, but it may have been the coincidental implementation of a new cost-cutting store management process that was to blame. The process, called Playbook, was based on Lean assembly-line production practices designed to maximize efficiency and speed, and it required store employees to maintain rigid schedules and stay on singular tasks. For example, a store employee might be tasked with cleaning tables at specific times, thus affecting the employee's flexibility to help on the second register during rush times. Many baristas complained on the Internet that Playbook prevented customer engagement, destroyed employee morale, and actually compromised and delayed service.[9]

The national media began taking notice of Playbook in 2010, when customer backlash regarding Starbucks's more mechanical, posttransformation focus on operational excellence first started. *The Wall Street Journal* reported that in an attempt to bring back the perception of an artisanal coffee shop, corporate headquarters was telling baristas to actually slow down their drink-making pace by preparing no more than two drinks at a time and steaming milk separately for each drink, which further exacerbated delays.[10]

The question remained whether these hiccups in the company's new system to support its growth strategy would prove to be temporary growing pains or early indications of more systemic future problems.

Tea

Starbucks made its first major move into branded tea in 1999, when it acquired the Tazo brand of bagged tea to be sold in Starbucks stores as well as through grocery stores and related channels. It also developed Starbucks- and Tazo-branded single-serve products, but it wasn't until 2012 that the company made another major move into the estimated $90 billion tea industry, and this one was meant to be a game changer. In its biggest acquisition to date, Starbucks paid a whopping $620 million in cash for Teavana Holdings, Inc., a purveyor of high-end loose-leaf teas and tea-making products that had 300 shopping mall locations. The company said it planned to expand Teavana's mall-based shops worldwide as well as develop stand-alone neighborhood tea shops with retail components, tea bars, and food menus. Schultz said: "We believe the tea category is ripe for reinvention and rapid growth. The Teavana acquisition now positions us to disrupt and lead, just as we did with espresso starting three decades ago."[11]

Schultz also explained that in much the same way that the company's Seattle's Best Coffee brand provided a lower price counterpoint to the higher-end Starbucks brand as a means of expanding the company's customer base, together with the Tazo brand, the Teavana acquisition would enable a two-tier approach to the immense and rapidly growing tea category. While Tazo would continue its pursuit of the less expensive bagged-tea market in grocery stores, Teavana would attract customers of premium loose-leaf tea.[12] As further proof of its dual strategy and commitment to both brands, in January 2014, Starbucks launched three new organic Tazo teas—Organic Earl Grey Blanc, Organic Earl Grey Noir, and Organic Sultry Strawberry—for sale exclusively at Whole Foods.

In 2013, Starbucks unveiled its design concept for the new stand-alone Teavana shops in two stores, including a flagship Teavana Fine Teas + Tea Bar in New York City and one in Seattle. The company said it would also debut Teavana-branded teas at Starbucks stores in 2014. To further illustrate his commitment and confidence in Starbucks's tea strategy, Schultz welcomed a surprise guest at the end of the company's 2014 annual shareholders meeting—celebrity talk-show host and philanthropist Oprah Winfrey, who announced her endorsement of Teavana. Winfrey and Starbucks had collaborated on a new tea blend called Teavana Oprah Chai Tea that debuted at Starbucks and Teavana stores later that spring. In another dose of goodwill for the Starbucks brand, Winfrey announced that her proceeds would be donated to three youth-education charities she supported.

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Never before had Winfrey agreed to endorse a commercial product in this manner, although she'd been pursued relentlessly for years. She told Starbucks shareholders it was because both tea and Starbucks "nurture the human spirit" that she took the plunge. Undoubtedly, it also helped that Winfrey and Schultz had become good friends since he had appeared on Winfrey's "Super Soul Sunday" show to discuss, in part, his social agenda for Starbucks.

During the spring and summer of 2014, the company expanded its Teavana-branded offerings with new shaken iced teas and new chai flavors at Starbucks stores and the opening of a new Teavana Fine Teas + Tea Bar location with new menu items in Los Angeles.

Starbucks Evenings

In 2010, Starbucks began an experiment to offer beer and wine after 4:00 p.m. in one nonbranded Seattle location. By the end of 2013, the company had expanded the project into a branded program called Starbucks Evenings in other cities such as Atlanta, Chicago, Los Angeles, Portland, other Seattle areas, and in the terminals at the Los Angeles and Washington Dulles International Airports. The company added the savory and sweet evening menu items bacon-wrapped dates and truffle macaroni and cheese to accompany the alcoholic beverages, which, by the end of FY2013, were sold in 23 select stores. With the help of a certified sommelier added to the ranks at Starbucks headquarters, the company devised individual wine and beer lists for the Starbucks Evenings in different regions.

Many industry analysts announced their skepticism about the potential success of the Starbucks Evenings concept, citing the complex web of differing state and local alcohol regulations as one reason why the expansion would prove more trouble than it was worth.[13] In contrast to the company's other aggressive steps to expand its food and drink offerings, however, Starbucks's strategy on this front remained relatively limited. Although Starbucks stated that additional stores would offer Starbucks Evenings "soon," the company also announced that it had no plans to add the adult beverages and evening menu beyond a "small selection of stores."[14]

Carbonated beverages

During the summer of 2013, Starbucks began testing its own carbonated, handcrafted, caffeine-free cold beverage called Fizzio, in select U.S. and Chinese markets. Based on the success of the experiment, Starbucks planned to roll out three flavors of Fizzio—Golden Ginger Ale, Spiced Root Beer, and Lemon Ale—in June 2014 in more than one-third of its U.S. company-operated locations. The company planned to debut more regionally derived flavors of Fizzio in locations in Singapore, Korea, and several Chinese cities as the 2014 summer progressed.[15]

Keeping Up with Coffee and the Core Business

In addition to attacking all the new strategies to expand product and menu offerings during this period, Starbucks continued to invest in its core business and strived to attract more customers and changing tastes. In 2012, Starbucks introduced Blonde Roast to appeal to the estimated 40% of U.S. consumers who preferred a lighter roast, many of whom had criticized Starbucks for its traditionally darker roasts by referring to it as "Charbucks."[16]

In the same year, Starbucks tapped into the $8 billion energy-drink market and the base of consumers who preferred a cold, fruity jolt to a warm coffee buzz by launching Starbucks Refreshers in two flavors: Cool Lime and Very Berry Hibiscus. The drinks derived their "energy" (i.e., caffeine) from flavorless green coffee extract made from unroasted beans. Julie Felss Masino, Starbucks's vice president of global beverage, said that this use of green coffee extract, which already was being used in cosmetics and pharmaceuticals, amounted to a "breakthrough innovation" for Starbucks.[17]

In addition to handcrafted versions prepared over ice in Starbucks stores, the company began marketing Refreshers in a ready-to-make powdered form (alongside its Starbucks VIA Ready Brew instant coffee brand) as a carbonated version in cans in three new flavors: Strawberry Lemonade, Raspberry Pomegranate, and Orange Melon.

For the traditional Starbucks consumer, the company also added more seasonal coffee beverages, expanded the line of its signature Macchiato to include a vanilla version (to join the original caramel and recently added hazelnut versions), and in 2010 started its Starbucks Reserve coffees—exotic and limited blends available at select stores by the half-pound or cup using the patented single-cup Clover brewing system, which Starbucks had acquired in 2008. Approximately 500 coffeehouse locations in 25 U.S. markets and 10 international markets offered the Clover brewing system technology in 2013.[18] The company announced plans to double its Clover locations by the end of 2014 and to introduce 14 different reserve coffees per year to its growing base of customers interested in unique, personalized coffee options.[19] The company also planned to continue innovating with the

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Clover system as part of its Internet-of-Things strategy by developing a process for keeping track of customers' preferences and settings.[20]

Additional investments to its core coffee business during this time included developing support centers for coffee farmers in Manizales, Columbia, and Yunnan, China, in 2012, and a new coffee-farming research and development center in Costa Rica.

Seattle's Best Coffee

Another chapter in the Starbucks posttransformation growth story involved the Seattle's Best Coffee brand, which the company had acquired in 2003 and then essentially ignored while the former rival remained in approximately 500 now-defunct Borders bookstores. Leading the charge on a new branding strategy was Michelle Gass, a veteran of the company who had been Schultz's chief strategist during the transformation agenda and had had major success both with marketing the Frappuccino in 1996 and introducing the Starbucks VIA Ready Brew instant coffee in 2009. After turning what was once a taboo practice in Starbucks circles (instant coffee) into $100 million in sales within 10 months of VIA's national launch, Gass said that Schultz called her into his office and stated, "I want you to turn [Seattle's Best] into a $1 billion business. You can do whatever you want."[21]

As president of Seattle's Best, Gass's approach was to take the brand to market through partnerships with Delta, Subway, Burger King, Royal Caribbean cruise line, AMC Theaters, Rubi Coffee Kiosks, and numerous other hotels, restaurants, airlines, convenience shops, college campuses, and grocery stores. Within a year, the brand expanded from 3,000 distribution points to more than 50,000. Starbucks decreased the Seattle's Best Coffee packaged line to five core offerings and revamped the packaging with new, brighter colors to replace the brown bags.

Although Starbucks never publicly admitted that reinvigorating the Seattle's Best Coffee brand at its lower price point and partnering with fast-casual retailers such as Burger King was a direct counter to McDonald's rollout of its McCafé brand of coffee drinks the previous year, it seemed to others that Starbucks' newest coffee rival was at least part of the story.[22]

After barely two years, the Seattle's Best Coffee transformation was deemed, by the company at least, to be a success, and Schultz again reassigned Gass to rescue another business line—the company's EMEA (Europe, the Middle East, and Africa) business division headquartered in London; however, by the end of FY2013, the Seattle's Best Coffee brand had not reached $1 billion in revenue. For financial reporting purposes, the brand was included along with Teavana, Evolution Fresh, and Digital Ventures under All Other Segments in the company's 2013 annual report. As a group, the segment generated $393.7 million, a $185 million increase over the previous year, which the company attributed to incremental revenues from the Teavana acquisition during Q2 of that year.

Starbucks's continued commitment to growing the business was illustrated during Q2 FY2014, when it announced new Seattle's Best Coffee's "house" and "breakfast blend" packaged varieties as well as a new bag design that represented a return to the more subdued colors of its old packaging. In an interview with Bloomberg, Jennifer Dimaris, the vice president of brand management for Seattle's Best Coffee, explained that the new varieties were replacing the previous varieties (labeled "one" and "two") because the lighter roasts, number-ranking system, and neon packaging weren't resonating enough with all customers.[23]

Dimaris also explained that these latest pushes into the grocery aisles for Seattle's Best Coffee were part of the company's "investing heavily" in the supermarket and retail store side of the business.[24] The same was true for nearly all the new products previously described. Yet Starbucks maintained a focus on shoring up its core retail coffee shop presence and customer experience, as well on expanding its storefronts internationally.

Store Improvement, Development, and Expansion

Starbucks' earlier, destructive growth strategy aimed at global domination was an attempt to commoditize the premium coffee shop—to combine ubiquity with higher-quality, pricier product offerings. As the company's dramatic, pretransformation growth implosion showed, that plan proved too elusive. By 2013, the company still aimed to be "the leading retailer and brand of coffee" in its target markets but this time in a "disciplined manner by selectively opening additional stores in new and existing markets, as well as increasing sales in existing stores."[25] By mid-2014, the company had expanded to 20,000 stores in 64 countries and was serving more than 70 million customers per week,[26] and yet the company claimed that by still only accounting for a small share of the total "global coffee occasions," it remained "significantly under-stored" and ripe for expansion in several markets, including North America, China, Brazil, and India.[27]

As evidence that the company had further honed its best-in-class store development and construction expertise,

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company executives pointed to a sales-to-investment ratio of more than 2:1, a return on investment in excess of 50%, and first-year average unit volumes of more than 1.2 million, all while Starbucks continued to deliver an "enhanced" customer experience.[28] After rolling out new Lean store techniques to cut costs during the transformation, now the company was highly focused on boosting its brand and generating customer loyalty by enhancing customer service and convenience, particularly with digital innovations such as free high-speed Wi-Fi and mobile payments. The company also wanted to dazzle with high-minded design and a new nod to regional and cultural differentiation, both domestically and internationally. The company divided its core coffee retail business into global divisions—Americas, China/Asia-Pacific (CAP), and EMEA—and developed 18 design studios with 200 designers around the world to better customize its stores and source locally.

Rather than locating a Starbucks on every corner (sometimes two), now the company focused on authenticity and a neighborhood feel. Building on its nonbranded neighborhood shop experiments in Seattle during the transformation, the design team focused on adding unique and local aesthetic touches (e.g., a chandelier made from old brass instruments at a New Orleans shop). The company even designed its seating arrangements to fit cultural norms, placing long communal tables in urban U.S. areas where strangers think nothing of sitting together and using more single stools for the impromptu group gatherings common in China and Mexico.[29]

Although massive customization still wasn't scalable and truly customized designs were limited to select, high-earning flagship locations such as Downtown Disney and Dazaifu, Japan, the company experimented with scaling regional designs—for example, using lighter flooring in sunny locales. In a 2011 interview with the *McKinsey Quarterly*, Schultz said:

What we're trying to do is create a balance between this being a Starbucks store with all the trappings and, at the same time, a very deep level of sensitivity to local relevancy. That's hard to do when you're all over the world in 55 countries. The reason it's working is that we're decentralizing and, for the first time, trusting that the people in the marketplace know better than the people in Seattle.[30]

In 2011, Starbucks rolled out a new prototype drive-through-only retail store with a walk-up window made from refurbished shipping containers in Tukwila, Washington. By early 2014, there were several such locations in the United States. In its Q1 FY2013 earnings call, the company announced that more than half of the 1,500 new U.S. stores the company planned to open during the next five years would have a drive-through component,[31] and in its Q2 FY14 earnings call, Schultz said the company's new class of "highly profitable drive-thrus represents a significant growth opportunity for us and continues to remain a focal point of our store development efforts."[32]

The Americas and Digital Ventures

The Americas remained the company's largest segment during this period, comprising 74% of revenue in 2013. A Seattle-based blogger estimated in 2012 that more than 80% of the U.S. population lived within 20 miles of a Starbucks location.[33] A total of 680 net new stores were opened in the United States in 2013.[34] Although that didn't exactly cover every street corner in America, it did illustrate that market saturation seemed closer than ever and that the company's prospect for growing through the addition of more brick-and-mortar storefronts was limited. Still, the company announced plans to increase net U.S. store openings by 13% by 2017.[35]

Comparable-store sales rose over this same period, but average ticket increases from such things as additional food items only accounted for one-third of that growth, meaning that increased traffic was the major driver. Part of that traffic increase resulted from steps to appeal to consumers during the lunch and evening hours with additional product offerings (Table 1).

The increase in traffic was likely due to improvements in customer service as well, or what Starbucks described in its 2013 annual report as the "Starbucks Experience." Boosting that experience were a robust loyalty program and major investments in its Digital Ventures business, including the addition of free and unlimited Wi-Fi in 2010 and mobile payments in 2011.

Yet by the end of Q1 FY14, analysts were already starting to downgrade their "strong buy" ratings of the company's stock because of a slowdown in the growth of U.S. comparable-store sales to the midsingle digits—down from 7% in 2013 and 8% in 2012 and 2011, respectively. The company attributed the slight drop in growth to increasing

Table 1 Percentage Change in Comparable-Store Sales for the Americas Segment*

Fiscal Year Ended	2013	2012	2011	2010	2009
Sales growth	7%	8%	8%	7%	(6%)
Change in transaction	5%	6%	5%	3%	(4)%
Change in ticket	2%	2%	2%	3%	(2)%

* Includes Starbucks company-operated stores open 13 months or longer.
Data source: Starbucks annual report, 2013.

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e-commerce and less foot traffic in brick-and-mortar retail shops during the 2013 holiday season. During the company's earnings call for that quarter, Schultz said: "No longer are many retailers only required to compete with stores on the other side of the street. They are now required to compete with stores on the other side of the country. Navigating the seismic shift will continue to be very, very difficult for me."[36]

Schultz also described how the unique Starbucks Experience, robust My Starbucks Rewards loyalty program, and ongoing digital investments would offset expected ongoing losses in traditional retail traffic.[37]

One of those investments was a new partnership with Google in 2013 to increase the speed of the Wi-Fi offered in Starbucks cafés to 10 times faster than the previous service powered by AT&T. In announcing plans to roll out the new Google service in all of its U.S. locations over the next 18 months, Starbucks's chief digital officer (CDO), Adam Brotman, said, "We're moving to much more of a streaming world across all media types."[38]

Increasing bandwidth to offer better web downloading and streaming for store customers was just one of many initiatives of the Digital Ventures group spearheaded by Brotman, who had joined Starbucks in 2009 to help form the group. The group's other initiatives during this period included creating mobile payment applications for iOS and Android; developing an in-house e-commerce platform and a branded Wi-Fi strategy featuring the Starbucks Digital Network (a page of original news and entertainment content to which users were directed when accessing the Wi-Fi at Starbucks); developing a social media engagement platform; and building the My Starbucks loyalty programs globally.

The group launched the mobile payment application in the United States in 2011. Then in 2012, Starbucks entered into a partnership agreement with mobile payments start-up Square to cover all the company's U.S. debit and credit card transactions. The agreement also gave Starbucks customers the option to use Square's mobile app, which through GPS technology allowed a customer to pay simply by saying his or her name. By the end of FY2013, Starbucks was processing 4 million mobile transactions per week, for a total of 14% of all U.S. store sales.[39] Rather than offering a mere convenience for customers, Brotman said the purpose of the app was to "enhanc[e] the experience and the relationship with the customer."[40] The application also enabled Starbucks to leverage its customer loyalty program by offering discounts, coupons, and an easy way for customers to reload their My Starbucks cards and rack up additional digital rewards called Stars, all of which made the loyalty program even stickier. During the 2013 holiday season alone, 1.5 million new members registered their Starbucks gift cards and joined the My Starbucks Rewards loyalty program for the first time.[41] The mobile application also provided a direct marketing link to customers. In 2014, analysts predicted that the mobile payments would be a game changer for Starbucks.[42]

Organizational shifts during this period reflected the company's investment in digital innovation as a new source of both growth and operational excellence. During the transformation, Schultz had given technology a seat at the executives' table for the first time when he hired former CNET VP of IT Stephen Gillett to the position of CIO, reporting directly to him on the senior leadership team. Prior to the transformation, the CIO had reported to the CFO. Gillett, who was 31 at the time, said he was intimidated by the level of responsibility and knew nothing about retail, but "[I]t was an exciting time in that Howard gave us a lot of leeway to reinvent the roles we were taking on and to develop some really creative ideas…Howard offered the permission to be curious and creative, and the rest took over."[43]

It was under Gillett that the company's IT department became a major source of cost leverage and efficiency. After Gillett departed Starbucks for a COO position at Symantec, new CIO Curtis Garner explained how the company's focus on technology had become customer- and employee-facing ("partner" in Starbucks parlance) as well:

We replaced the point-of-sale system in our stores, a fairly routine thing that a retailer would do. After spending a bunch of time videotaping and talking to partners, we made a couple of changes to the point-of-sale system to make it easier to ring transactions and decrease the time it takes to do an electronic transaction. We were able to save 10 seconds a swipe for any kind of Starbucks card, mobile payment, credit card, or debit card transaction. That ended up saving us 900,000 hours of line time a year.[44]

It was also in March 2012 that Schulz promoted Brotman to the newly created post of CDO, putting Starbucks on the forefront of companies investing in a top digital position. The company again illustrated its focus on the growth potential of its Digital Ventures business when it announced another organizational shift during Q2 2014. CFO Troy Alstead was promoted to the newly created position of COO to take over day-to-day operations management from CEO Schultz, which, the company explained, freed up Schultz to work more closely with Brotman and Chief Security Officer

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Matt Ryan on next-generation retailing and payments initiatives.[45] One such new initiative the company planned to launch by the end of 2014 was mobile ordering.[46]

In its FY2014 second-quarter earnings conference call, Schultz stated that as the retail industry's "unquestioned" leader in mobile payment and mobile loyalty, Starbucks was uniquely positioned to develop and monetize its digital leadership into new platforms, revenue streams, and growth.[47] As an example, Schultz revealed that Starbucks had been approached by major tech companies and retailers about licensing its mobile technology and platforms and said the company was taking a very "thoughtful and disciplined" approach to analyzing these overtures.[48]

Starbucks also invested heavily in social media during this time, including the Starbucks Digital Network, as well as Facebook, Twitter, Instagram, Pinterest, YouTube, Google+, and a successful crowdsourcing platform called My Starbucks Idea, which served not only to generate ideas, but also as a tool for marketing and customer engagement. The company's Twitter presence became even more lucrative when it started a Tweet-a-Coffee campaign in October 2013. Through the campaign, customers could send friends a $5 Starbucks gift card via Twitter by first linking their Starbucks accounts and credit cards to the social media platform. By December of that year, Starbucks had linked 54,000 users' Twitter IDs to their mobile phones and customer IDs—a boon that far overshadowed the $180,000 in purchases that were made through the program in its first two months. With more than 33 million fans, Starbucks was one of the most "liked" consumer brands on Facebook,[49] and its My Starbucks Idea online community had generated more than 80,000 ideas. One of the most popular customer-generated ideas was digital tipping, which Starbucks added as a feature to its mobile payment app in 2014.

To advertise its focus on both operational excellence and growth through innovation, Starbucks also announced plans to leverage the Internet of Things by turning its store refrigerators and coffee makers into smart machines that could alert store employees when the milk was about to spoil, for example. The company also planned to experiment with coffee cup sensors to monitor coffee quality and collect data on such customer preferences as cream and sugar.[50]

The company clearly saw Digital Ventures as a major driver of new growth, customer loyalty, and shareholder value; however, Starbucks continued to bet heavily on international expansion by planning for almost 900 new global stores in 2014.

EMEA

The company's EMEA business segment continued to struggle toward profitability during this period. Comprising 8% of total revenues, comparable-store sales remained flat in 2012 and 2013. Due to cost-management efforts and a major shift in ownership structure away from company-operated stores in favor of licensed and franchised stores, however, EMEA operating margins improved to 5.5% in fiscal 2013, and a 2% growth in total revenue for 2013 came from licensed-store revenue growth.[51]

Under a store licensing model, previously shunned by the company before the transformation but now making up a large and growing percentage of its international revenue, Starbucks received a reduced share of store revenues but also a disproportionately reduced share of expenses borne mostly by the licensee. At the end of FY2013, the region had 853 company-operated stores and 1,116 licensed stores, down from 911 and up from 707 respectively in 2009.[52]

By Q2 FY14, same stores for EMEA were up 6%.[53]

CAP

In contrast to EMEA, the relatively young CAP segment increased revenues by 27% in 2013. Although it only comprised 6% of the company's total revenues, it was the fastest-growing business segment and had the highest profit margin. During 2013, the company added 600 net new stores, including 317 in China and its first stores in Vietnam and India.[54] Starbucks clearly saw the region as one of the major sources of growth and said it planned to have 1,500 stores in China by the end of 2015.[55] But it was India that earned the title of fastest-growing market in Starbucks history during this period. Through a 50-50 joint venture with Tata Global Beverages Limited, the first Starbucks store opened in October 2012, and India had a total of 40 stores only 17 months later.[56]

"The biggest opportunity we have is clearly in Asia," Schultz told the *Wall Street Journal* in September 2013. "We've been in China now for over a decade. The most gratifying thing is, when we first got there, most of our customers were tourists and expats, and now they're Chinese nationals."[57]

Channel Development

Probably the most interesting part of Starbucks' post-transformation growth story occurred outside the iconic Starbucks coffee shop. What had started with the sale of packaged Starbucks and Seattle's Best Coffee beans and ground coffee at supermarkets grew during this period into an aggressive, multifaceted strategy to turn the coffee

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giant into a diverse consumer packaged goods (CPG) company. By the beginning of 2014, Starbucks' CPG business included sales of whole-bean and ground coffees, premium Tazo teas, Starbucks- and Tazo-branded single-serve products, ready-to-drink beverages such as Starbucks Refreshers and Evolution Fresh juices, Evolution Harvest snack bars, and other branded products sold worldwide through grocery stores, warehouse clubs, specialty retailers, convenience stores, and foodservice accounts.

In 2012, this segment, which Starbucks called its channel development business, experienced a whopping 50% net revenue increase (due in part to taking all distribution activities back from Kraft) before landing at a more sustainable pace of 10% growth, or $1.4 billion in revenue in 2013 (9% of total company revenue). It is important to note that those numbers did not include the relatively new CPG business from the Evolution Fresh brand, which Starbucks still accounted for under All Other Segments in its 2013 annual report. A consolidated look at the mix of net revenues for all of CPG and other segments as a percentage of total revenues and against net revenues from company-operated stores and licensed stores is provided in Table 2. According to Schultz:

There hasn't been one company I can identify that has been able to build complementary channels of distribution by integrating the retail footprint and the ubiquitous channels of distribution—in our case, grocery stores and drug stores. So the model is, Starbucks can seed and introduce new products and new brands inside our stores.[58]

Notably, it was in 2013 that Starbucks finally settled a legal dispute with Kraft Foods that stemmed from Starbucks's 2011 termination of a contract with Kraft to distribute Starbucks and Seattle's Best Coffee. In a binding decision, an arbitrator ordered Starbucks to pay Kraft $2.7 billion in damages, interest, and legal fees for terminating the contract three years prematurely. Although Starbucks issued a statement saying it fully disagreed

Table 2 Net Revenues by Segment as a Percentage of Total Net Revenues

Net Revenues	FY13	FY12	FY11	FY10	FY09
Company-operated stores	79.2%	79.2%	82.3%	83.7%	83.7%
Licensed stores	9.1%	9.1%	8.6%	8.2%	8.1%
CPG, food service, and other	11.7%	11.7%	9.1%	8.1%	8.2%
Total net revenues	100%	100%	100%	100%	100%

Data sources: Starbucks annual reports, 2011–13.

with the arbitrator's decision, Schultz stated that ending the relationship was the right call at the time:

We are literally in [the] very nascent stages of building a multibillion-dollar global consumer packaged business… Having gained full operating control, we now have the flexibility and the freedom to control our own destiny and, most importantly, preserve and enhance the Starbucks Global business and brand around the world.[59]

It wasn't only packaged coffee that the break with Kraft affected. It was also in 2011 that Starbucks entered the single-serve coffee-pod market through a partnership with Keurig Green Mountain (formerly Green Mountain Roasters), which manufactured Keurig K-Cup coffee brewing systems for home and commercial use. Keurig was the U.S. leader among systems that with the push of a button forced a high-speed jet of water to pierce a small coffee capsule and filtered a single-serve cup of coffee within 30 seconds. As part of the Kraft deal, Starbucks had been limited to producing single-serve coffee exclusively for Kraft's much less popular Tassimo system.

The Keurig system required a patented K-Cup capsule for its machines, and the partnership agreement with Keurig made Starbucks the producer of the exclusive, licensed super-premium coffee brand used in the K-Cup pods; however, by 2012, Keurig's patents had expired and generic K-Cup pods began flooding the market, which was growing at a rapid pace. Starbucks continued its aggressive pursuit of single-serve that year by launching its own branded system, the Verisimo, for brewing not only coffee but also espresso drinks and lattes. Then, in 2013, the company expanded the Keurig partnership to triple the number of Starbucks K-Cup products and brands covered, including Seattle's Best Coffee, Torrefazione Italian Coffee, Teavana, and Starbucks cocoa. By 2014, Starbucks had 15% of the single-serve market and had agreed to amend the Keurig agreement to terminate its exclusive position for supplying premium coffee in exchange for better business terms.

Rather than cannibalizing coffee store sales and, in the case of the Verisimo, its successful Keurig partnership, Starbucks saw the single-serve market as fitting into its customers' daily routine, and with the espresso- and latte-brewing Verisimo, attracting an entirely different customer segment from Keurig.[60] Because U.S. consumers purchased $3.1 billion worth of coffee pods in 2013 versus $132 million in 2008, it clearly was an area Starbucks couldn't afford to ignore. In a conference call to discuss Q1 FY2014 earnings results, Troy Alstead said the company's premium single-cup platform would be a significant driver of the company's long-term growth.

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Starbucks also continued to experience success and growth in channel sales of its ready-to-drink beverages through its North American Coffee Partnership with PepsiCo, which manufactured and distributed Starbucks bottled energy drinks, Frappuccinos, Refreshers, iced coffee, and Tazo teas.

In other developments during this time, Starbucks introduced Evolution Fresh products in grocery stores and unveiled that exclusive organic line of Tazo-bagged teas for Whole Foods. Despite a May 2013 price reduction on packaged coffee to reflect the lower cost of coffee beans, the company continued to achieve revenue growth and increased operating margins. During the Q2 FY2014 earnings call, Alstead said the company continued to see packaged coffee as a growth driver that would sustain channel development's expected double-digit revenue growth. The company had increased from about 50 employees running the segment in 2010 to about 500.[61]

In summer 2013, Starbucks also began a cross-channel program to link its My Starbucks Rewards to grocery store purchases of Starbucks packaged coffee. As of Q2 FY2014, the company had issued 5 million Stars to grocery customers.[62]

Schultz said that he believed sales in this segment, which as of FY2013 were worth about $2 million per year, could reach $10 billion per year in the United States alone.[63] Schultz claimed this was possible because of the "flywheel effect":[64] "We can introduce a product in our stores and then use social media and mobile payments to draft off that unique asset. That reduces the cost of customer acquisition and creates value," he said.[65]

Shortly after Starbucks began testing its Fizzio carbonated beverages in select cafés during the 2013 summer, it was this flywheel notion that helped generate rumors that Starbucks might acquire a stake in the Israeli at-home soda machine manufacturer SodaStream. In fact, Coca-Cola had recently acquired a stake in rival Keurig and finalized a deal to collaborate on a Keurig at-home cold beverage system, making the SodaStream strategy seem plausible at the time; however, both Starbucks and SodaStream declined to comment on the speculation.[66]

Leadership, Culture, and Employee Engagement

We are a performance-driven company through the lens of humanity.[67]

—Howard Schultz

During this same period of rapid growth, Starbucks also invested heavily in its organizational brand, which internally was focused on culture and employee engagement and externally Schultz saw as "redefining the role and responsibility of a for-profit, public company."[68]

"I recognize we are not a perfect company," Schultz said at the 2014 annual meeting of shareholders, "but we have a responsibility to use our scale for good. The currency of leadership is truth and transparency. What we need now more than ever before is citizenship over partisanship."[69]

More than mere rhetoric, the company used the turnaround to not only share the wealth with its shareholders in the form of dividends and with its employees in the form of compensation and benefits, but also with the community at large through several social initiatives. Starting with the transformation, the company also implemented new internal policies that eliminated the kind of leadership hubris that likely contributed to its previous growth implosion and focused on cultivating the kind of organizational system whereby the structure, culture, and leadership behaviors fostered innovation, experimentation, and employee engagement.

Implementing these policies was a humbled but invigorated leadership team. Eight of ten senior leaders had departed the company in the wake of the transformation, and a majority of the senior leadership as of 2013 had either joined the company or the team since Schultz returned as CEO. But loyalty was a factor too. As of 2013, four of the five highest-paid executive officers under Schultz had been promoted from within the company and had tenures dating back from 1992 to 2002—well before the turnaround. Schultz hired the other top executive, Jeff Hansberry, president of Starbucks China and Asia-Pacific, in 2010 to grow the CPG business globally. Hansberry came with prior experience from E. & J. Gallo Winery and 17 years with Procter & Gamble.

In 2010, Schultz had high praise for his new senior leadership team, stating, "Our team meets weekly as well as monthly, and as a group we are open to building consensus; we welcome creative tension, and we always try to learn from our past."[70]

By all accounts, Schultz himself set the tone for this new, more humble form of leadership by "walking the talk." Whereas he'd previously been perceived by the media as headstrong, egoistic, and overly ambitious, Schultz now took pains to publicly admit his mistakes and tried to change his ways by embracing focus groups and taking more controlled, smaller risks with new products and initiatives. Alstead told *The New York Times* in 2011, "There's been more arguing, challenging, and debate in the last two to three years than there's ever been," and Michelle Gass said Schultz had become more disciplined and a better listener.[71]

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Loyalty and employee engagement were factors in this new growth period not only at the top but also throughout the organization. Despite its cost-cutting during the transformation and rising health insurance premiums in the wake of the Affordable Care Act (causing many other public companies to slash employee coverage), Starbucks maintained its medical, dental, life, and disability insurance benefits for eligible full- and part-time (more than 20 hours per week) employees and continued to give them a free pound of coffee per week. Starbucks also kept up its Bean Stock program—an employee stock-purchase plan for both full- and part-time employees that Starbucks started in 1988. Starbucks remained one of the only retailers to offer a stock program to part-timers. In 2013, the company spent $250 million insuring its full- and part-time employees. That same year, it shared $234 million in pretax stock gains with employees and matched $50 million in 401(k) contributions.[72]

One Wall Street blogger called the level of satisfaction among Starbucks employees the company's "magic bullet" that contributed to its success during this period of rapid growth.[73] The blogger claimed that the company's generous benefits motivated employees to provide the superior customer service that justified Starbucks' higher prices.[74] Some evidence of this perceived employee satisfaction was the positive feedback given on the employee rating site Glassdoor.com—a 3.7 out of 5 overall rating and an 88% CEO approval rating in Q2 2014.

Perhaps what contributed at least as much as the generous benefits program to employee satisfaction and engagement during this time was the fact that Starbucks had become "cool" again. In February 2014, Nitrogram 50, a website that calculated the top 50 brands on Instagram, listed Starbucks as number two, thanks to its 2,398,226 followers and 11,345,441 comprehensive posts on hashtag, (i.e., photos of Starbucks coffee cups, morning lattes, and café scenes posted by Instagram users).[75]

During its downturn, Starbucks became a poster child for growth run amok—the popular satirical newspaper the *Onion* once published an article titled "New Starbucks Opens in Rest Room of Existing Starbucks."[76] Now, however, the company's more artisanal and disciplined retail footprint, savvy social media presence, and declared focus on both high quality and the environmentally sustainable and ethical sourcing of its products[77] restored its cachet and earned admiration. Having been absent from everyone's "best" lists for years, in 2011, Schultz was named *Fortune*'s Business Person of the Year, and Starbucks placed 16th on *Fortune*'s list of the Top 50 Most Admired Companies in 2011. By 2013, the company was 5th on the list.

Community Service

It was also in 2011 that Schultz began taking very public stands on political and social issues. He incited a media frenzy by publicly announcing his disgust regarding the dysfunction in the U.S. Congress and then working to fix it. In an open letter, Schultz urged fellow CEOs of public companies to join him in boycotting all campaign contributions in order to send a message to politicians who had "chosen to put partisan and ideological purity over the well-being of the people."[78] CEOs from 140 companies joined the boycott.

During the October 2013 federal government shutdown, Starbucks led a nationwide petition through its company-operated U.S. stores and digital channels to reopen the government.[79] Within a week, the company collected nearly 2 million signatures, which Starbucks employees personally delivered to the U.S. Congress and the White House. The month prior, Schultz had sent an open letter to customers asking them to refrain from bringing firearms into Starbucks stores.[80] Earlier that year, Schultz told an outspoken shareholder at the 2013 annual meeting that he was free to sell his shares when the shareholder complained about a dip in the stock price after the National Organization for Marriage launched a "Dump Starbucks" boycott the previous year. In defending the company's support of marriage equality, Shultz responded, "It is not an economic decision. The lens in which we are making that decision is through the lens of our people. We employ over 200,000 people in this company, and we want to embrace diversity."[81]

Schultz received high praise from other shareholders inside the meeting room as well as later in the media for his response to the disgruntled shareholder. No doubt, the fact that Starbucks stock had earned a 38% return in 2012 helped most investors accept Starbucks'—or, more appropriately, Schultz's—more aggressive political profile.

In addition to the ethical sourcing and environmental sustainability initiatives undertaken by Starbucks during this time, the company also used its brand and coffers to address the growing wealth gap. Starbucks created a nonprofit funding model called a community store. In five such U.S. stores and one in Thailand, a Starbucks café partnered with a local nonprofit to help revitalize a struggling neighborhood by providing jobs as well as a source of funding for the nonprofit. Starbucks also helped launch the Create Jobs for U.S.A. program with the Opportunity Finance Network to provide loans to small businesses. Starbucks also pledged to hire 10,000 veterans and military spouses by 2018 and to open five

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new community stores to help support veterans entering the civilian work force and the spouses of active-duty military personnel. In doing so, Starbucks not only raised its brand's profile in the eyes of socially minded customers but also increased goodwill among its employees.

Conclusion

"If Starbucks was a 20-chapter book, we are only in chapter 4 or 5 and heading toward a $100 billion market cap," Schultz told shareholders at the company's 2014 annual meeting.[82] "Our ability to grow income at a pace that exceeds revenue growth clearly demonstrates the strategic synergies we generate across our global footprint, which combined with the diversity of our portfolio, enables consistent delivery of excellent results," said Troy Alstead in the Q3 FY2013 earnings release.[83]

By Q2 2014, it certainly seemed that Starbucks had found a winning synergistic strategy. From the coffee snobs to the health-conscious, and from the millennials who embraced a more digital third place to the world's estimated millions of tea drinkers who'd never stepped into a coffee shop, Starbucks seemed poised to attract continued growth.

But several questions about its strategy loomed as well. Would Starbucks' diverse bets on digital assets, global expansion, consumer packaged goods, and tea counteract an inevitable slowing of its core U.S. coffee shop business? Could it really do for tea what it had done for coffee? Would Starbucks hold off its growing list of competitors—from the cheaper quick-service restaurants such as McDonald's and Dunkin' Donuts; more experienced casual food purveyors such as Panera Bread; and single-serve beverage companies such as Keurig?

Considering its diverse and growing portfolio, new focus on technology and innovation, and reinvigorated organizational system aligned with its growth strategy, was Starbucks armed to combat another economic recession? And even more important, would Starbucks be able to manage its appetite for growth to avoid its previous mistakes? Was the Starbucks multiple-stakeholder model firmly entrenched enough to avoid dilution from future leadership successions?

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