

Starbucks 2007

I was faced with a dilemma. On the one hand, I wanted to support Jim's decisions and forge ahead with our growth goals. On the other hand, the cracks I sensed in our foundation, such as deterioration in the store experience greatly disturbed me—as did hearing concerns from third parties. I felt trapped between two poles. My quandary was intensified by my love of the company and my sense of responsibility to partners and shareholders.

Howard Schultzⁱ

Howard Schultz, Chairman, Starbucks Coffee Corporation (Starbucks), reflected as he reviewed the developments in the company in December 2007. The stock price had dropped to \$20 that month. McDonalds, a fast food retailer, and Dunkin Donuts, a bakery retailer, had emerged stronger with their offer of *Espresso* coffee. Second Cup, a Canadian coffee chain company, had succeeded in entering the US. Internationally, Starbucks faced competition from Costa Coffee, a British coffee chain founded in 1971. Customers had begun to migrate from Starbucks to other stores to try out the new offerings of competitors. The Starbucks stores appeared to have lost their charm of *'Theatre and Romance'*. It also appeared that employees, who were referred to as partners by Schultz, were not finding any difference between working for Starbucks and other competing coffee companies or food retailers despite benefits like health insurance and stock options. Schultz shared his views on the developments in Starbucks with James Donald (Jim), Chief Executive Officer of Starbucks, in a memo. See exhibit 1 for the details of the memo. The key questions that bothered Schultz in this context were: Were the strategic directions pursued by his successors Orin Smith and Jim Donald appropriate in view of the heritage of Starbucks and the developments in the external business environment? Was there a need to modify? If yes, how should it be executed and who should execute it? What should be his role in the process? If no, how should the company respond to the possibility of declining performance and disappointment in the stock market? Schultz owned 4.4 per cent of about 726 million shares.

By 2007 Starbucks had 15,000 stores across 56 countries. Most of the stores were company owned and constituted majority of the revenues. See exhibits 2a, 2b, and 3 for details.

Schultz felt that the expansion of product offerings had led to problems in operations and supply chain. "The chance of a store getting everything it asked for on time and intact was about 35 per cent and it was highly likely that every day thousands of stores were out of something."ⁱⁱ He also noted that the smell of burnt cheese suppressed the aroma of coffee in one of the stores visited by him. In one instance when he requested the store manager to remove the sandwiches from shelves, he was told that the customers loved them and that they helped in bringing new customers to the store.

Prepared by Professor D. Karthik and Professor Mukund R. Dixit, Indian Institute of Management, Ahmedabad. This case is based on published sources.

Cases of the Indian Institute of Management, Ahmedabad, are prepared as a basis for classroom discussion. They are not designed to present illustrations of either correct or incorrect handling of administrative problems.

Heritage of Starbucks

Starbucks traced its origin to a store called Starbucks Tea, Coffee, and Spice promoted by Gordon Bowker, Zev Siegel, and Jerry Baldwin in 1971 at 2000 Western Avenue at Pike Market in Seattle, Washington. They were inspired by Alfred Peet, a coffee vendor, to sell high quality coffee beans and durable coffee accessories such as coffee making machines and coffee mugs. The company specialised in dark roasting the bean to get the full flavour of coffee. It educated its customers about the best way to make the coffee beverage though it did not sell the beverage itself. It made the beverage for demonstration purposes and offered it to the customers for free. Howard Schultz was hired by them as the company's marketing director in 1981. Influenced by the Italian espresso bars, Schultz had made a proposal to his employers that the company should start selling the beverage like in these bars. They refused by stating that they were in the business of roasting beans and educating the customers and not in the business of selling beverages. In 1985, Schultz started his own store called 'Il Giornale' in Seattle, Washington, to provide a unique coffee experience. The store served coffee beverage in an ambience of good music. The store got support from Baristas and came to be known as the third place, away from home and office, with opportunities for relaxation. It charged a premium price which was six to seven times that of basic coffee served in restaurants.ⁱⁱⁱ As Il Giornale stores became popular, Schultz acquired the Starbucks brand in 1987 from his erstwhile employers and renamed his stores as Starbucks stores. The company went public on June 26, 1992 and expanded its operations in the United States and Canada. The number of Starbucks stores increased from 2 to 1,074 between 1986 and 1996. The stores were located in 'A' class sites such as focal points of central business districts and large metropolitan locations, and were operated by the company. The first Starbucks outlet outside North America was set up in Japan in 1996.

Schultz emphasised that Starbucks stores offered 'coffee with experience' to its customers. This included the location of the place and the dim lit bar-like ambience. The customers also received information from trained Baristas about varieties of coffee as they made *Café Latte*¹ by freshly grinding the exact quantity of roasted beans, pulling shots of espresso from the machines, perfectly steaming milk, and adding foam. Schultz considered this 'theatre and romance with aroma' to be integral to the Starbucks experience. The Baristas went through 24 hour training before taking charge of the espresso machines. Starbucks soon became not just a coffee brand but part of a lifestyle:

Just by carrying a Starbucks white cup encased in a brown java jacket and speaking the company's made-up Italianesque lingua franca, customers identified themselves as belonging to, and got the value of membership in, a group of successful people with hip, urbane tastes; an understanding of the finer things in life; and concern about the planet, the less fortunate, and the global order. For much of the Starbucks moment, customers believed that their grande lattes demonstrated that they were better than others—cooler, richer, and more sophisticated.^{iv}

In the 1990s Starbucks pursued growth through retail expansion, selling beans through grocery chain, partnerships with Airlines and retailers of books and fashion goods, and collaborative new product introduction like *Frappuccino* with Pepsi, a soft drinks major and premium ice cream with Dryer Ice cream. It created special blends for retail chains like COSTCO, a discount chain. It entered into an agreement with Kraft, its rival roaster, to

¹ *Latte* referred to milk and coffee.

distribute whole bean and ground coffee in supermarkets and grocery stores.^v Starbucks started the mail order and online retailing of coffee to expand the reach in 1994. It had consistently refused offers of partnership with McDonalds, a fast food retailer with stores across the world. In 1996, it set up a state of the art roasting facilities as centralised facilities in select places in USA. It developed alternative blends of roasted beans to get the right flavours. The processes were computerised and incorporated into the roasting machines. The roasted beans were packed in a single way valve bag to retain freshness for 26 weeks. Starbucks did not grow its own coffee beans. It sourced them through its agents from various plantations located across the world. To manage its rapid growth Starbucks recruited executives from Pepsi, Pathmark, Wendy's, and Taco Bell for their retail operations experience.^{vi} In 1999 the company introduced Tazo tea in its stores. By 2000 Starbucks had 3,500 stores spread across 17 countries; of these 2,685 were operated by Starbucks and the rest were through licences. The stores offered specialty food like bakery items and potato chips in addition to espresso beverages. The total sales of the company increased from \$1.7 billion to \$2.2 billion and operating income from \$156 million to \$212 million. The number of employees increased to 24,465 when Schultz handed over charge of chief executive officer (CEO) to Orin Smith and assumed the role of Chairman and chief global strategist of the company. Schultz desired to increase the number of Starbucks stores in the world by working with partners and forging alliances around the world.

Orin Smith in Charge

Orin C Smith, an MBA from the Harvard Business School, joined Starbucks as Vice President and Chief Financial Officer in 1990. Prior to joining Starbucks, Smith had spent 14 years with Touché Ross & Co in the management consulting division, where he was partner-in-charge of the Northwest practice. In 1994, he became president and chief operating officer of Starbucks. In 2000, he became the CEO. When Smith joined Starbucks, the company had 45 stores in the US and Canada. According to him,

Starbucks sceptics never expected that it would keep growing so long. But people remain more than willing to pay premium prices for a cup of Joe, or new peppermint, toffee, and malt-flavored drinks. Automatic espresso machines and the Starbucks Card have helped shorten the lines at the counter. Speed of service is a critical issue for us.

On taking charge Smith noted that Starbucks was an established brand. The loyalty of its customers was high and the number of customers wanting to have coffee in Starbucks had increased. The queues in the stores had started lengthening. The baristas needed to serve the customers quickly to avoid long queues being formed at the order receiving counter. Smith responded to this problem of queues by installing a new type of espresso machine. Till 2000 the baristas used the manual La Marzocco² machines which helped them create hand-crafted beverages. The machines took one full minute to make lattes. In addition, they were fatigued by the repetitive motions that handcrafting entailed.^{vii} In 2001, the company swapped the La Marzocco machines with tall Verismo espresso machines. The machines had

² Coffee was brewed using either the drip method using coffee filter; French press, where a plunging device was used; and espresso machines. Espresso machines were preferred because unlike other methods the combination of steam and pressure resulted in a thicker consistency of coffee concentrate. The espresso machines were introduced in Europe in the early 20th century. These machines provided thicker beverage by injecting steam at high pressure into the freshly ground coffee powder. The machines led to the formation of coffee foam with creamy texture because of the pressure. Espresso machines came in various levels of automation. La Marzocco espresso machines required more manual steps compared to Verismo semi-automatic espresso machines.

sensors which stopped the foaming of milk at the desired moment. The new machines reduced the time taken to make lattes from a minute to about thirty six seconds.^{viii} While the machines solved the queuing problem they created dissatisfaction among some customers. They complained that the tall machines blocked the view of barista making their beverage. The machines also gave an impression of barista simply pushing a button to make coffee and not delivering on the experience part of customers' smelling, seeing, and hearing their coffee being made.^{ix} Taking cue from the top management to focus on efficiency some baristas started steaming large quantity of milk and then re-steaming when the customers placed order. To some customers' dismay, Starbucks coffee did not taste fresh.

Roasting Beans

The centralization of roasting had begun with the setting up of a state of the art facility in Kent, Washington in 1993 and York, Pennsylvania in 1996. Two more roasting plants were added, one each in Carson Valley, Nevada and Amsterdam, Netherlands in 2003. This was strengthened further by setting more centralized facilities for roasting and sending pre-roasted coffee in pressurized bags to the stores and other distribution channels.

New Products

After observing that many customers came to the store with sandwiches from other food chains, Starbucks introduced warm breakfast sandwiches in 2003. Some stores also offered stuff toys to increase sales. These items were also offered because of their high gross margins.^x The company diversified into entertainment after customers requested for the compilation of songs that were played in the stores. It had acquired "Hear Music" a San Francisco based company in 1999 and started co-producing albums in 2003. The CD-burning Hear Music bars debuted in October 2004, at the start of a holiday season in which digital music technology, in the form of iPods, gained enormous market share. After a faltering effort to establish as a food retailer in 1998 through an independent Starbuck café, it entered the food business in 2003 by integrating the offer of food items into its existing store format.

Acquisitions and Partnerships

Starbucks acquired Seattle's Best Coffee in 2003 to sell coffee to non premium segment and expand its reach with about 160 stores.

Starbucks® whole bean and ground coffees, as well as Seattle's Best Coffee®, and Torrefazione Italia® branded coffee and a selection of premium Tazo® teas, acquired in 1999, were also made available to the customers through the grocery and warehouse club stores in the US through a licensing relation with Kraft Foods Inc.. Kraft was responsible for distribution, marketing, advertising, and promotion. To access international markets Starbucks entered into agreement with other grocery and warehouse clubs.

On April 8, 2004 the company entered into a development and distribution agreement with Jim Beam to market a premium Starbucks branded coffee liqueur product in the US. Smith felt that many Starbucks customers enjoyed coffee liqueur and were expected to welcome Starbucks Coffee Liqueur. Jim Beam was a leading player in liqueur and cordials, and the spirits and wine business. On February 7, 2005 the company introduced a coffee liqueur product in restaurants, bars, and retail outlets where premium distilled spirits were sold. This market represented a total 4-6 billion dollars. The company had decided that it would not sell liqueur products in its own or from licensed retail stores.. The 750 ml bottle was priced at \$23, which was \$5 above the competitors' offer. The cream liqueur contained

alcohol and coffee extract. Double Shot was introduced as a chilled coffee and cream drink in a can. North American Coffee Partnership with Pepsi – a cola company and Starbucks Ice Cream where the company held 50 per cent of the equity interests, sold Frappuccino and Starbucks Double Shot espresso drink, and super premium ice cream.

Internationalization Thrust

Smith continued to expand internationally through licensing and joint ventures. The number of international stores increased from 772 in 2000 to 2,888 stores in 2005. In September 2005, the company launched Starbucks Discoveries™, a ready-to-drink chilled cup coffee beverage, in convenience stores of Japan and Taiwan through a manufacturing distribution agreement with Suntory Limited Uni-President Enterprises Corporation.

Starbucks focused on institutional food service companies that offered products to business, industry, education, and healthcare accounts, office coffee distributors, hotels, restaurants, airlines and other retailers to shelf whole bean and ground coffees, including the Starbucks, Seattle's Best Coffee and Torrefazione Italia brands, as well as a selection of premium Tazo teas. In 2003 it collaborated with SYSCO Corporation and the US Foodservice to augment its reach.

Jim Donald in Charge

Orin Smith handed over charge to Jim Donald in October 2005. Donald had joined Starbucks in 2002 as the President of North American Operations. Earlier he had worked with retail chains like Wal-Mart and Safeway. In his address to the reporters Schultz mentioned:

Generally speaking the people who operate grocery stores are the best at what they do because they have to operate within a set of disciplines, because of the competitive nature of the business, the commodity nature of the business and how low the margin is.^{xi}

Smith mentioned

We started the search for my successor over three years ago, and we found an individual we thought would be a good fit with the culture. While we looked at the other experiences the individual had, and the functional skills, and of course the results, the big issue was: is he going to work out here? We didn't really know. But we said, "This is going to be at least a two-year process and we're going to take you through the various parts of the organization. We'll give you one set of responsibilities and then we'll add to it over time." Jim Donald, my successor, was already a CEO of a company, albeit a smaller one. It will be two and a half years that he's been in this development program with us.

As of October 2, 2005, the company employed approximately 115,000 people worldwide. In the US, Starbucks employed approximately 97,500 people, with 91,200 in retail stores and the remainder in the administrative and regional offices, and store development, roasting, and warehousing operations. Approximately 17,500 employees were employed in International company-operated retail stores, regional support facilities, and roasting and warehousing operations. By the end of 2005 Starbucks increased the number of stores to 10,241. The sales and profits increased to \$6.4 billion and \$781 million respectively. Speciality sales that included royalties and fees from licensees and product sales from speciality operations accounted for 15 per cent of the total sales in fiscal 2005. Starbucks

opened 596 new licensed retail stores in the US and 341 international licensed stores. By the end of fiscal 2005, the company's coffees and teas were available in approximately 31,300 grocery and warehouse club stores, with 30,000 in the US and 1,300 in international markets. Revenues from this category comprised 24 per cent of specialty revenues. Product sales and royalty and license fee revenues from the US and international licensed retail stores accounted for 42 per cent of specialty revenues in fiscal 2005. The licensed retail operators provided access to important locations. Employees working in licensed operations were required to follow Starbucks operating procedures and attend training classes similar to those given to the employees of company-owned operations.

As a part of the succession planning initiative James L. Donald was hired from outside in October 2002 as president, North American Operations. Earlier, Donald served as Chairman, President, and Chief Executive Officer of Pathmark Stores Inc., a chain with 143 stores. Prior to that, he held senior management positions with Albertson's Inc., Safeway, Inc., and Wal-Mart Stores, Inc. According to Schultz, Donald was the ideal person to manage the nuts-and-bolts of the company. He said, "I'm only six months older than he is, but I don't have the stamina that he has." He continued, "Orin's style was more through the lens of an administrator, and Jim's style is through the lens of an operator. Jim is more hands-on and field-driven, whereas I think Orin did a lot of work through others." Schultz felt that Donald's habit of donning an apron and working in the stores made him "a person without airs, a person who is very transparent, very honest, very authentic, and is as comfortable talking to the man on the street as he is sitting in the executive office." Donald and Schultz kept copies of *Joe* magazine, Starbucks' failed publication venture with Time Inc. in their offices to remind themselves that seemingly good ideas could fail. To that effect, Donald also saved the company from misfire when Mazagran, a half-empty bottle carbonated coffee drink developed with PepsiCo did not make it. He noted the difference between working in a super market and in Starbucks. In the supermarket business, the focus was on cost because margins were thin and growth was small. At Starbucks cost control was important, but investing in building a growth trajectory was more important. Based on the early initiatives of Donald, Schultz remarked that Starbucks was bringing out the best of Jim as it challenged him.

Donald described himself as a simple guy who brewed coffee, straight black. He was fanatical about communicating and did his own e-mails. According to him the office needed to operate like a store and ensure quicker communication. He carried a hardback black binder with him and noted down when someone said something particularly smart or not smart to coach people or give reviews. He visited about 20 stores a week when in Seattle and ten a day when travelling. He opined that one could tell how a store was doing by smelling it. He used to stick his nose in pastry display and check out the rest rooms. He communicated with the partners.

On taking charge, Donald commented that he did not plan to shake things up too much and he preferred to keep on the track of driving growth through store expansion and introduction of new products. Schultz hoped that Donald would steer Starbucks towards its long term goal of 40,000 stores, 20,000 in the US and 20,000 in International markets. The company entered into a partnership with Hyatt to target A class locations. Other partnerships with hospitals, colleges, airports, grocery stores were formed to increase the access of Starbucks. These stores were staffed by licensee's employees and followed training guidelines formulated by Starbucks to ensure high quality experience for the customers.^{xiii}

Developments in the Coffee Industry

The US was the largest market for coffee in the world with a per capita consumption of 4 kg, though the European average per capita consumption was 5 kg.^{xiii} Among the producing nations, Brazil was the highest producer of coffee followed by Vietnam and Columbia.^{xiv} Retail and Food service were the primary distribution channels for coffee constituting about 46 per cent of the production. Grocery was the dominant channel selling 70 per cent retail coffee sales.³ Coffee reached the end consumer through these channels after passing through the stages from ripe berries in the coffee plantations located in various parts of Asia, Africa, and America to dry cherry to green coffee to roasted beans. Organised roasting companies like Starbucks purchased about 60 per cent of both *Arabica* and *Robusta*⁴ coffee beans produced.^{xv} The nature of roasting made a difference to the aroma and taste of coffee. Starbucks had specialised in dark roasting Arabica beans. It was among the top ten roasters purchasing 50 per cent of Arabica imported in the US.

Pressure on Fair Price for Farmers

The coffee farmers were unorganized and poor and were paid a very small proportion of the price charged to the end consumers. Fluctuating production and prices also left the cultivators at the vagaries of the market forces. The price paid for Robusta was lesser than the price paid for Arabica. The plight of farmers led activist groups to advocate fair trade of coffee in the late 1990s. Fair trade coffee entailed trade without the coffee trader thereby ensuring higher prices to the cultivators. Certified practices included terms such as purchasing only from those registered with an independent agency, guaranteeing a minimum price to the farmers, provision of credit against future sales, and helping farmers stay out of debt of the middlemen. Fair trade coffee was about developing long term trade relationship with fair trade distributors and providing stability to farmers in otherwise volatile market.^{xvi}

While the whole coffee industry was facing pressure to embrace fair trade practices, Starbucks being the leading premium retailer of coffee in the world was facing even more pressure. The environmental groups advocated shade method of cultivation which was found to be more eco- friendly.⁵ Since the yield was low and Starbucks required higher quantity for its growing enterprise, it resisted such moves.^{xvii} In 2000 Starbucks was accused of purchasing coffee from farms employing child labor. Due to the negative publicity that followed, Starbucks introduced ethical coffee-sourcing guidelines developed with Conservation International in 2001.⁶ To extend fair trade coffee to international locations as well, Starbucks entered into licensing agreements with international Fair Trade organizations to sell Fair Trade Certified™ coffee. In early 2000, there was a growing consumer demand for products made using environmentally and socially sustainable

³ See the following link for details of various segments of premium coffee in the US.

http://www.dolcera.com/wiki/index.php?title=Premium_Coffee_Consumers_Market_Segmentation

⁴ *Arabica* and *Robusta* were two different varieties of coffee. It was perceived that Arabica was a superior variety of coffee. The specialty coffee producers like Starbucks used Arabica beans while the commercial coffee producers like Nestle used both Arabica and Robusta beans.

⁵ Coffee was produced both organically using traditional shade method of cultivation or under full sun which required increased use of fertilizers and pesticides since sun caused berries to ripen faster. The quality of coffee beans is said to be superior in the shade method although the yield is lower for the same amount of fertilizer used.

⁶ Conservation International was a non-profit organization whose mission was to spearhead initiatives for protecting environment and biodiversity for the benefit of humanity.

practices. Although Starbucks purchased highest proportion of fair trade coffee among the top ten roasters, the proportion was only about 5 per cent of its total purchase (Exhibit 4).

Competition

Starbucks growth coincided with the growth of specialty coffee industry. According to Specialty Coffee Association of America, there were about 15,500 coffeehouses (also including kiosks, carts, bean roaster/retailers, and specialty bean sales) across the US in 2006.^{xviii} This number was expected to be about 18,000 by 2015. Almost half of these specialty stores were owned or licensed by Starbucks. The second leading player was Caribou with about 322 stores and Tim Horton with about 292 stores.^{xix} The more intense competition came from local stores and fast food companies like McDonald and Dunkin' Donuts.

Starbucks local competitors offered handcrafted beverages sometimes at premium prices. A local store in New York offered espresso which even Howard Schultz agreed to be as good as the best coffee offered by Starbucks at \$6 a cup, four times the price charged at Starbucks for an espresso. Other companies such as Caribou Coffee or Coffee Bean and Tea Leaf which had not expanded as fast as Starbucks, had a loyal customer base. They also provided the look and feel of local espresso bars. McDonald and Dunkin' Donuts were seen by the Industry as more aggressive competitors.

Dunkin' Donuts was a doughnut company that specialized in baked goods. Although Dunkin's had been offering coffee for six decades, it started offering espresso beverages i.e. cappuccino⁷ in 2003. Its reach of about 5,700 stores was almost same that of Starbucks' 5,239 stores in the US in 2003. Its price was also about 70 cents lower than Starbucks comparable cup.^{xx} Dunkin' Donuts offered coffee to complement its fast food offering and targeted the customers who needed low-priced coffee more quickly. It brewed coffee continuously and offered it to the customers as they demanded their cup of coffee. Dunkin' Donuts sourced its coffee through Proctor & Gamble and had announced that all the coffee offered in its stores was fair trade certified by Transfair, USA.

McDonald entered the gourmet coffee industry in 1993 by setting up McCafe in Australia. In the US it set up its first McCafe in Chicago in 2003. At the time of entry into the US, McCafe had 300 stores in 17 countries. The McCafe stores distinguished themselves from McDonald stores by using fine china and stainless steel flatware were instead of Styrofoam containers.^{xxi} They served espresso beverages with bakery items such as muffins. These stores were located either as independent locations or by the side of McDonald stores. McDonald experimented with offering specialty coffee in about 800 regular stores. In 2007^{xxii} encouraged by the increase in sales of beverages by 39 per cent in the first nine months of the same year, it was contemplating to offer specialty coffee in 14,000 stores.^{xxiii}

While Dunkin' Donuts and McDonald coffee offering did not promise any experience, they offered similar taste. Some customer surveys rated the specialty coffee offered by these companies to be better than coffee offered by Starbucks.^{xxiv}

Situation in 2007

By the end of 2007 the sales of Starbucks was \$9.4 billion with the operating income of \$1 billion. The company desired to realize an annual total net revenue growth of approximately

⁷ *Cappuccino* had less steamed milk in coffee than latte. It was made with one third espresso coffee, one third steamed milk, and one third milk foam.

20 per cent and annual earnings per share growth of approximately 20-25 per cent for the next three to five year period. The challenges, according to Schultz, were in ensuring a consistent supply of high quality raw materials, hiring sufficient number of key employees, maintain an effective system of internal controls for a globally dispersed enterprise, and training employees worldwide to deliver a consistently high quality product and customer experience.

The stock market was not happy with the performance and initiatives of Starbucks. The share price had been declining continuously. See exhibit 5 for the trends in the stock prices. The prices paid to the growers were increasing. See exhibit 6 for details. In view of these developments, Shultz had to review the performance of Starbucks and decide the course of directions in the future. He was also required to articulate his own role in the company as the new directions unfolded.

EXHIBIT 1**Starbucks Chairman warns of "the Commoditization of the Starbucks Experience"**

From: Howard Schultz

Sent: Wednesday, February 14, 2007 10:39 AM Pacific Standard Time

To: Jim Donald

Cc: Anne Saunders; Dave Pace; Dorothy Kim; Gerry Lopez; Jim Alling; Ken Lombard; Martin Coles; Michael Casey; Michelle Gass; Paula Boggs; Sandra Taylor

Subject: The Commoditization of the Starbucks Experience

As you prepare for the FY 08 strategic planning process, I want to share some of my thoughts with you.

Over the past ten years, in order to achieve the growth, development, and scale necessary to go from less than 1,000 stores to 13,000 stores and beyond, 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.

Many of these decisions were probably right at the time, and on their own merit would not have created the dilution of the experience; but in this case, the sum is much greater and, unfortunately, much more damaging than the individual pieces. For example, when we went to automatic espresso machines, we solved a major problem in terms of speed of service and efficiency. At the same time, we overlooked the fact that we would remove much of the romance and theatre that was in play with the use of the La Marzocca machines. This specific decision became even more damaging when the height of the machines, which are now in thousands of stores, blocked the visual sight line the customer previously had to watch the drink being made, and for the intimate experience with the barista. This, coupled with the need for fresh roasted coffee in every North America city and every international market, moved us toward the decision and the need for flavor locked packaging. Again, the right decision at the right time, and once again I believe we overlooked the cause and the effect of flavor lock in our stores. We achieved fresh roasted bagged coffee, but at what cost? The loss of aroma -- perhaps the most powerful non-verbal signal we had in our stores; the loss of our people scooping fresh coffee from the bins and grinding it fresh in front of the customer, and once again stripping the store of tradition and our heritage? Then we moved to store design. Clearly we have had to streamline store design to gain efficiencies of scale and to make sure we had the ROI on sales to investment ratios that would satisfy the financial side of our business. However, one of the results has been stores that no longer have the soul of the past and reflect a chain of stores vs. the warm feeling of a neighbourhood store. Some people even call our stores sterile, cookie cutter, no longer reflecting the passion our partners feel about our coffee. In fact, I am not sure people today even know we are roasting coffee. You certainly can't get the message from being in our stores. The merchandise, more art than science, is far removed from being the merchant that I believe we can be and certainly at a minimum should support the foundation of our coffee heritage. Some stores don't have coffee grinders, French presses from Bodum, or even coffee filters.

Now that I have provided you with a list of some of the underlying issues that I believe we need to solve, let me say at the outset that we have all been part of these decisions. I take full responsibility myself, but we desperately need to look into the mirror and realize it's time to get back to the core and make the changes necessary to evoke the heritage, the tradition, and the passion that we all have for the true Starbucks experience. While the current state of affairs for the most part is self induced, that has led to competitors of all kinds, small and large coffee companies, fast food operators, and mom and pops, to position themselves in a way that creates awareness, trial and loyalty of people who previously have been Starbucks customers. This must be eradicated.

I have said for 20 years that our success is not an entitlement and now it's proving to be a reality. Let's be smarter about how we are spending our time, money and resources. Let's get back to the core. Push for innovation and do the things necessary to once again differentiate Starbucks from all others. We source and buy the highest quality coffee. We have built the most trusted brand in coffee in the world, and we have an enormous responsibility to both the people who have come before us and the 150,000 partners and their families who are relying on our stewardship.

Finally, I would like to acknowledge all that you do for Starbucks. Without your passion and commitment, we would not be where we are today.

Onward...

Source: http://starbucks_gossip.typepad.com//2007/02/starbucks_chair_2.html accessed on December 24, 2012.

EXHIBIT 2a
Growth of Stores

Year	US		INTERNATIONAL		TOTAL	
	Company-operated Stores	Licensed Stores	Company-operated Stores	Licensed Stores	Total Stores Opened	Total Stores
Earlier					116	116
1992	42	1	6	0	49	165
1993	86	8	13	0	107	272
1994	120	14	18	1	153	425
1995	205	23	24	0	252	677
1996	264	22	46	6	338	1,015
1997	305	14	65	13	397	1,412
1998	324	33	80	37	474	1,886
1999	390	42	79	101	612	2,498
2000	391	342	113	157	1,003	3,501
2001	504	268	158	278	1,208	4,709
2002	507	264	125	281	1,177	5,886
2003	578	389	140	232	1,339	7,225
2004	521	417	164	242	1,344	8,569
2005	580	596	189	307	1,672	10,241
2006	810	733	246	410	2,199	12,440
2007	1,065	723	297	486	2,571	15,011

Source: <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTI0MjY4fENoaWxkSUQ9LTF8VHlwZT0z&t=1> accessed on December 24, 2012.

EXHIBIT 2b
Starbucks Stores in 2007

Asia Pacific		Europe/Middle East/Africa			The US	
Japan	722	Turkey	82	United States		3,891
South Korea	215	Spain	68	Canada		234
China	212	Greece	64	Mexico		159
Taiwan	209	Saudi Arabia	58	Other		26
Philippines	119	Kuwait	49			
Malaysia	92	United Arab Emirates	47			
Indonesia	58	France	37			
New Zealand	45	Switzerland	35			
		Other	84			
Total	1,672	Total	524	Total		4,310

Source: Starbucks Annual Report, 2007

EXHIBIT 3
Financial Performance

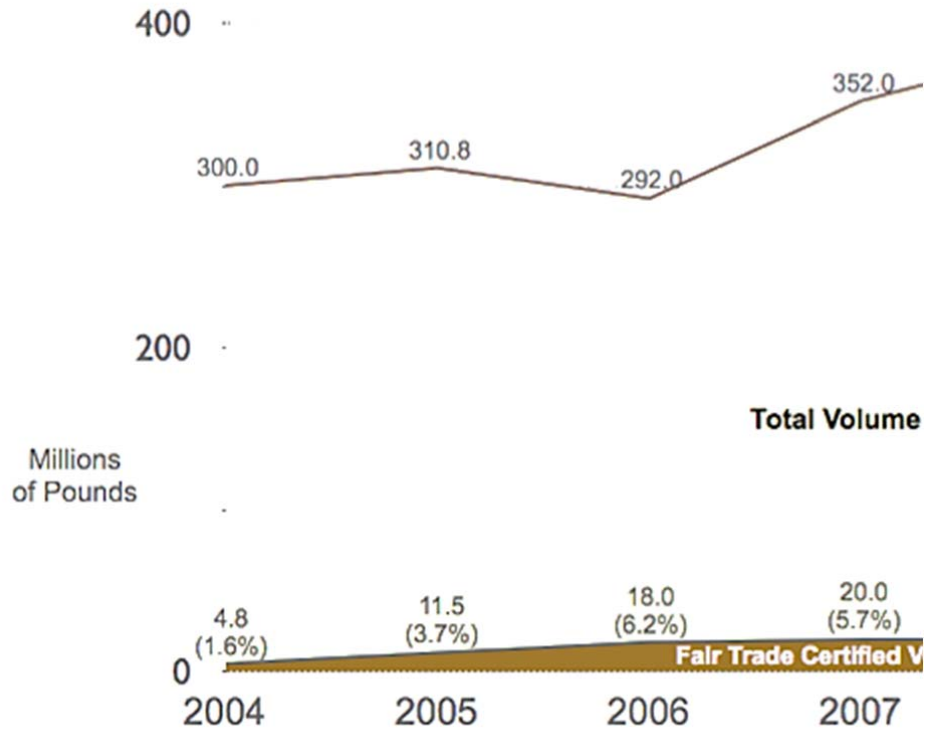
As of and for the Fiscal Year Ended	Sept 30, 2007 (52 wks)	Oct 1, 2006 (52 wks)	Oct 2, 2005 (52 wks)	Oct 3, 2004 (53 wks)	Sept 28, 2003 (52 wks)	Sept 29, 2002 (52 wks)	Sept 30, 2001 (52 wks)	Oct 1, 2000 (52 wks)	Oct 3, 1999 (53 wks)	Sept 27, 1998 (52 wks)
Results of Operations										
Net revenues:										
Company-operated retail (<i>in \$</i>)	7,998	6,583	5,392	4,457	3,450	2,792	2,229	1,823	1,423	\$1,102
Specialty:										
Licensing	1,026	861	673	566	410	312	241	189		
Foodservice and other	387	343	304	271	216	184	179	165		
Total specialty	1,413	1,204	977	837	626	496	419	354	263	206
Total net revenues (<i>in \$</i>)	9,411	7,787	6,369	5,294	4,076	3,289	2,649	2,178	1,686	1,308
									-	8
Operating income	1,054	894	781	606	421	316	280	212	156	109
Internet-related investment losses						-	3	59	-	-
Gain on sale of investment						13	-	-	-	-
Earnings before cumulative effect of change in accounting principle	673	581	494	389	265					
Net earnings (<i>in \$</i>)	673	564	494	389	265	212	180	94	101	\$68
Balance Sheet										
Working capital (deficit) (<i>in \$</i>)	-459	-406	-18	605	336	310	148	146	135	\$157
Total assets	5,344	4,429	3,514	3,386	2,776	2,214	1,783	1,435	1,252	992
Long-term debt (including current portion)	551	3	4	4	5	5	6	7	7	2
Short-term borrowings	710	700	277	-	-					
Shareholders' equity (<i>in \$</i>)	2,284	2,229	2,090	2,470	2,069	1,723	1,374	1,148	961	\$794
Store Information										
Percentage change in comparable store sales ⁸										
United States (<i>in %</i>)	4	7	9	11	9	7	5	9	6	5
International (<i>in %</i>)	7	8	6	6	7	1	3	12	20	28
Consolidated (<i>in %</i>)	5	7	8	10	8	6	5	9	6	5

Source: Starbucks Annual Reports (various years)

⁸ 'Comparable store sales' is a commonly used measure for retail stores. It is the amount of revenue generated in the current year relative to previous year. For more details see <http://www.investopedia.com/terms/c/comparable-store-sales.asp>

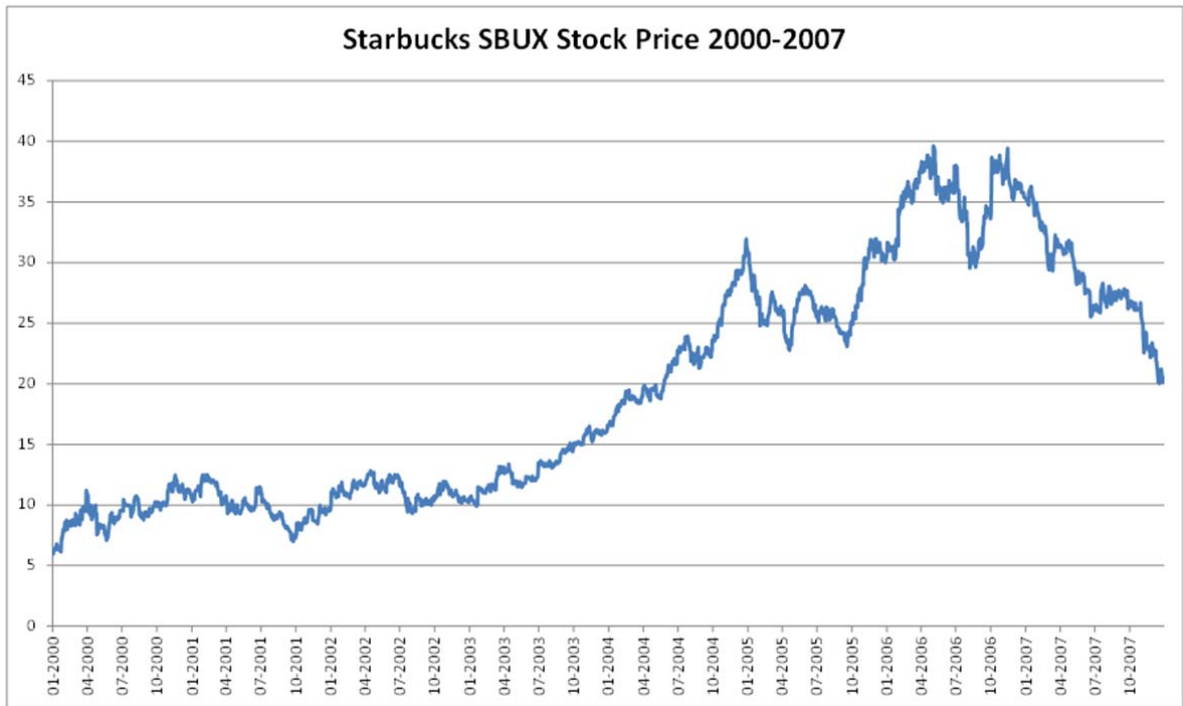
EXHIBIT 4

Starbucks: Global Green Coffee & Fair Trade Certified Purchases



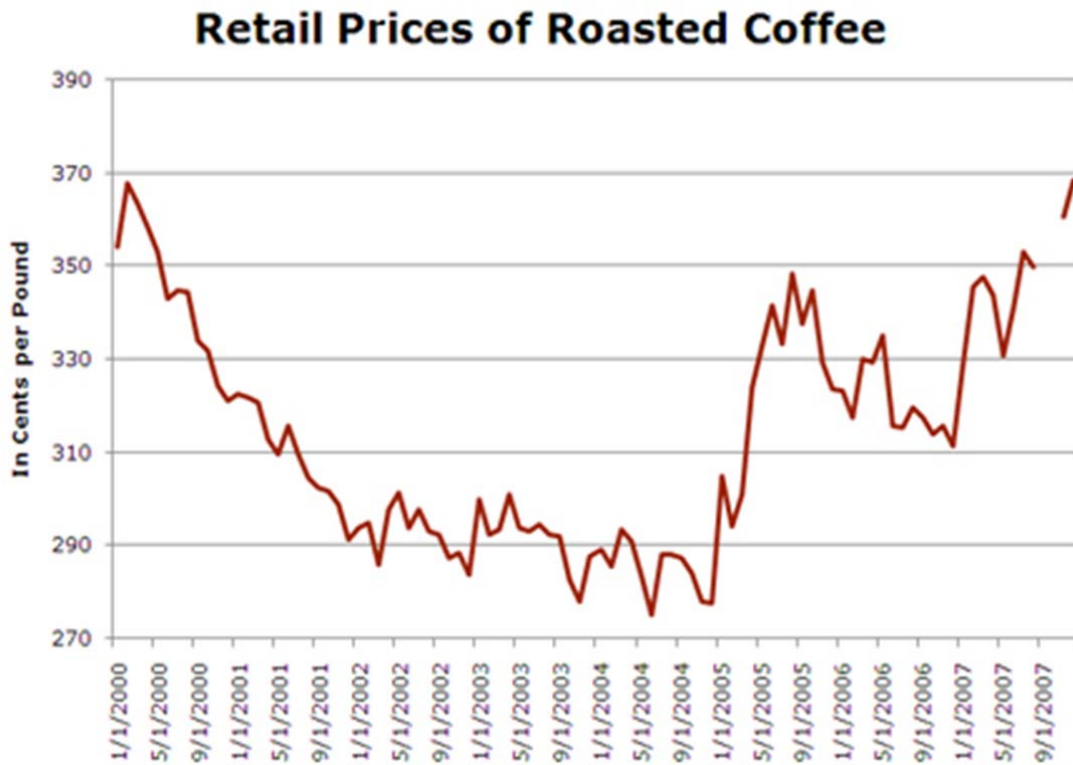
Source: <https://www.msu.edu/~howardp/coffee.html> accessed on December 24, 2012.

EXHIBIT 5



Source: Google Finance, accessed on December 24, 2012.

EXHIBIT 6



Source: <<http://www.accuval.net/insights/industryinsights/detail.php?ID=101>> accessed on December 24, 2012

ENDNOTES

ⁱ Schultz, H. (2012). *Onward: How Starbucks fought for its life without losing its soul*. Rodale. page 22

ⁱⁱ Ibid page 186

ⁱⁱⁱ

<http://news.google.com/newspapers?id=ITJPAAAIBA&sjid=Vo8DAAAIBA&pg=6612,1729045&q=coffee+vs+espresso+price&hl=en>

^{iv} Simon, B. (2009). *Everything but the coffee: Learning about America from Starbucks*. Univ of California Press. page 7.

^v http://articles.chicagotribune.com/1998-09-29/business/9809290217_1_kraft-foods-starbucks-beans-and-ground-coffee

^{vi} Simon, B. (2009). *Everything but the coffee: Learning about America from Starbucks*. Univ of California Press page 44

^{vii} Ibid. *Onward* page 121

^{viii} Clark, T. (2013). *Starbucked*. Hachette UK. Page 108

^{ix} Simon, B. (2009). *Everything but the coffee: Learning about America from Starbucks*. Univ of California Press page 45

^x Schultz, H. (2012). *Onward: How Starbucks fought for its life without losing its soul*. Rodale. page 90

^{xi} <http://www.seattlepi.com/business/article/Jim-Donald-brings-new-energy-to-Starbucks-CEO-post-1169846.php#ixzz2GZLv45VZ> " accessed on December 24, 2012.

^{xii} <http://blogs.starbucks.com/blogs/customer/archive/2009/06/02/questions-about-licensed-stores.aspx> accessed on December 24, 2012.

^{xiii} http://www.worldmapper.org/posters/worldmapper_1038_coffee_consumption_ver2.pdf on date?

^{xiv} <http://www.ico.org/prices/po.htm> accessed on December 24, 2012.

^{xv} Fellner, K. (2008). *Wrestling with Starbucks: Conscience, capital, cappuccino*. Rutgers University Press. page 3

^{xvi} <http://www.coffeeresearch.org/politics/fairtrade.htm> and http://en.wikipedia.org/wiki/Fair_trade_coffee#cite_note-autogenerated5-1 accessed on December 24, 2012.

^{xvii} <http://www.globalexchange.org/fairtrade/coffee/faq> accessed on December 24, 2012.

^{xviii} <http://business.highbeam.com/industry-reports/food/roasted-coffee> accessed on December 24, 2012.

^{xix} <http://www.slashfood.com/2006/06/11/the-10-largest-coffee-chains-in-the-us/#ixzz28WJ7mxkW> accessed on December 24, 2012.

^{xx} <http://www.deseretnews.com/article/515033639/Dunkin-Donuts-brings-espresso-to-the-masses.html?pg=all> accessed on December 24, 2012.

^{xxi} <http://www.entrepreneur.com/article/40494> and <http://abcnews.go.com/Business/story?id=88248&page=1#.UOCFk4lesSh> accessed on December 24, 2012.

^{xxii} http://articles.chicagotribune.com/2007-12-03/business/0712020170_1_franchisees-national-leadership-council-owner-operators accessed on December 24, 2012.

^{xxiii} <http://articles.latimes.com/2007/nov/18/business/fi-consumerbriefs18.s1> accessed on December 24, 2012.

^{xxiv} <http://www.msnbc.msn.com/id/16951509/#.UNflwm872k8> accessed on December 24, 2012.