The Starbucks Corporation:
Past, Present and Future

By Hervé R. AUCH-ROY – PEN: 1207HA

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A) Introduction

- An unusual coffee encounter -

On a sunny Wednesday morning of April, my customer visit was scheduled for 10 am. As usual, I was early and decided to get a cup of coffee and review my presentation material. I pulled into the parking lot of the first mall, and walked into what I thought was a regular coffee shop; I was in for a surprise. At first, I went back to my car with my cup, and as I was going to turn on my laptop computer, my cell phone rang: the meeting was postponed. The strong fresh coffee aroma had already filled up my car, and I recalled the warmth of this shop that I just walked out of; now that I had plenty of time, I decided to go back there and sit down for a while. This shop was unlike any other I had experienced; people there remembered me and greeted me with a “Nice to see you again!”. Somehow, they must have known that I would come back. I picked up a newspaper and sat at the counter; I remember feeling captivated by the atmosphere.

Looking around me in the shop, I noticed that many items were for sale as well: cookies, teas and mugs. I grabbed my cup and looked at the logo, and remembered that I had been in another one of those coffee shops somewhere else in the US. “That must be a chain of some sort”, I remember thinking. Back at home that evening, I went onto the internet to look for it. I discovered the Starbucks Corporation.

How can a coffee shop be a “corporation”? And why did it feel so familiar to walk in that coffee shop that day?

B) Starbucks: Past

B.1) Early days

- The original coffee shop: cofounders’ philosophy -

It all started in 1971 when English teacher Jerry Baldwin, history teacher Zev Siegel, and writer Gordon Bowker opened a store called “Starbucks Coffee, Tea, and Spice” in Seattle, WA. They shared a passion for quality coffee and exotic teas, and named the shop after the coffee-loving first mate in Herman Melville’s Moby Dick. While they invested themselves $1,350 each, they had to borrow another $5,000 from the bank.

In the beginning, they purchased their coffee from Alfred Peet, a Dutch immigrant who had started a coffee shop in the San Francisco Bay Area in 1950 (“Peet’s Coffee and Tea”). Alfred Peet was a passionate for coffee, and he urged them to deepen their knowledge. Soon, the Starbucks cofounders purchased a used roaster from Holland, and set up roasting operations in a nearby ramshackle building. Baldwin was keeping the books and developing a growing knowledge of coffee, and Bowker was the "magic, mystery, and romance man.", in charge of maintaining the store ambiance. By the early 1980s, four Starbucks store were in operation in Seattle, and while they have been profitable since the first day, the roles and responsibilities of the cofounders underwent change; Zev Siegel experienced burnout and left the company to pursue other interests. The key in the original Starbucks success was the cofounder's knowledge of the product and service, and the carefully chosen location of the stores in Seattle.
- **Howard Schultz enters the picture** -

Howard Schultz was Vice President and General Manager of the US operations for Hammarplast, a Swedish maker of stylish kitchen and house wares. In 1981, Schultz noticed that a little company in Seattle, WA, was placing orders of a certain coffeemaker, in larger volumes than the big US store Macy’s; he decided to pay them a visit to see what was going on. Gordon Bowker, the *magic, mystery, and romance man*, must have shared his passion for quality coffee and tea with Howard Schultz at this time, because he got hooked right away. This Starbucks store that Schultz visited was more than just a regular coffee shop; it had a soul, a passion and authenticity. People there were educated to quality coffee, and they in turn were educating their customers.

The original Starbucks stores were very successful in Seattle, and this was apparently due to a good mix in a deep knowledge for a high quality product, customer education and good business sense. However, anybody can get educated to good coffee, and a few small shops like Starbucks would be eaten out by competition if they don’t plan on expansion; this is what Howard Schultz understood right away.

Baldwin, Bowker and their partner in San Francisco, Alfred Peet, were kind of shy towards the excitement of Schultz to open Starbucks stores all over the country. It took him a lot of time to convince them that he should become part of them, and in September 1982, he started there. Since then, history has shown that Schultz’s vision was the right thing to do.

Baldwin and Bowker trained him for several months before they let him do the coffee beans roasting. At the same time, Schultz knew that, in order to lead the people at Starbucks, he needed to blend in the culture, and build trust and credibility. He made a strong point in acclimating himself to this new life in the Pacific Northwest.

The seeds of the Starbucks Corporation were planted there: deep knowledge of the product and service, trust and credibility, and the beginning of a vision for the future.

- **Collecting ideas** -

Schultz was bubbling over with ideas; his brightest one came in 1983 while he was attending an international house ware show in Milan, Italy. As he walked in several espresso bars, the counter worker (“barista”) cheerfully greeted him, while serving other customers and calling them by their name. Different espresso bars had different ambiance, each one with its own character, and gathered different style of customers, but always featuring a high energy barista performing as if in a great theater. Schultz soon understood that something was missing at Starbucks: creating an atmosphere and bonding with customers around a cup of coffee.

He came back with the recommendation for Starbucks to serve fresh brewed coffee, espresso and cappuccino in addition to coffee beans and equipment. Coffee would be only the vehicle for a place where people want to stay for a while, a sort of place-like-home, in between home and office. That should become the differentiating factor of Starbucks.

- **Expanding the vision and building the concept** -

But far from convincing Baldwin and Bowker, Schultz encountered strong resistance from them as to diversify Starbucks activities into serving fresh brewed coffee.
Baldwin and Bowker had a different strategy: they intended to purchase Peet’s Coffee and Tea enterprise in San Francisco, and pursue along the line of local stores providing high quality coffee beans and teas. The cost of this acquisition would leave very little for Schultz's plans anyway. But the operations didn’t go smoothly after that for Baldwin and Bowker; managing the stores back and forth between Seattle and San Francisco caused the employees to feel neglected, even more as their bonus was not paid due to the tight financial situation of Starbucks at that time. Starbucks suffered from a lack of confidence from its employees, and the business was in danger, calling for an action from the management to regain trust.

Schultz kept pressuring Baldwin to let him do a market test of selling beverages in one Starbucks store. Although the experience was a success, Baldwin perceived it as moving into the path of a place to get a quick cup of coffee to go, and this was not in line with the original strategy for Starbucks. Meanwhile, Howard Schultz had experimented at that time a key tactic in the history of Starbucks: there was no pre-opening marketing blitz, and no sign announcing that espresso was now served at Starbucks. It was part of a deliberate experiment to see what would happen. Despite this first success, the experience was not pursued, and Schultz's growing frustration made him leave Starbucks in 1985, to start his own venture.

- Howard Schultz’s Il Giornale venture -
This first experience at Starbucks forged high energy Schultz’s vision for his first coffee related business: Il Giornale (pronounced ill jor-nahl-ee, meaning “The Newspaper” in Italian). Schultz’s strategy at that time was to open espresso bars in high-traffic downtown locations that would emulate the friendly, energetic atmosphere he had encountered in Italian espresso bars. Being aware that he would need to raise venture capital and eventually go public, he managed to get help from a corporate lawyer by the name of Scott Greenberg. As Jerry Baldwin invested $150,000 in Il Giornale, Howard Schultz made a significantly appropriate move by appointing Baldwin director of the new company, and Gordon Bowker as a part-time consultant; in doing so, Il Giornale would benefit from the combined experience of Baldwin and Bowker in coffee shop business and customer interaction, laying down the foundation for a future growth.

Early 1986, Greenberg and Schultz had raised an initial $400,000 in seed capital, and put together a plan to raise another $1.25 million in equity, in order to launch at least eight espresso bars. Many of the investors whom they presented the plan to misunderstood it; they saw only the commodity side of the coffee business as most of them failed to see the key success factor of his venture: a gathering and social place, where people would possibly drink quality coffees and teas.

While the coffee consumption was declining, Howard Schultz had a vision of what the future will hold: people would rather look for the atmosphere of an up-scale shop where they would gather with friends. Unfortunately, he seemed to have had difficulties in communicating his vision, which cost him time. Nevertheless, his persistence allowed rising up to $1.65 million, and five of the major investors became directors of the new company.

Another key move from Howard Schultz was to hire Dave Olsen, who had accumulated a very valuable experience in running coffee shops. Not only had Olsen coffee expertise, but he knew how to form and communicate a vision, raise money, find good store locations, build a brand name and plan for growth. The stores were improved based upon customer's requests, and Il Giornale grew steadily to a $1.5 million business after a year and a half of operations over three stores.
B.2) Shifting gears
- A shift in the company profile: Starbucks acquisition -
A major change occurred in 1987 when Jerry Baldwin and Gordon Bowker decided to sell the whole Starbucks operation in Seattle (the stores, the roasting plant, and the Starbucks name). Baldwin decided to move to San Francisco and keep Peet's Coffee and Teas, because, as he said “It was the original and it was better”.

Schultz immediately decided to acquire Starbucks, and won over a rival plan put together by another Il Giornale investor. In August 1987, the acquisition was completed, and at age 34, Howard Schultz became Starbucks Corporation’s president and CEO.

Although in line with Howard’s strategy, this move produced a significant shift in the profile of the company; from a small coffee shop chain, Starbucks was engaged on the path to become a nation wide company. Jerry Baldwin’s remark also marked a change in the perception of the company; Starbucks haters (that we’ll discuss further on) don’t share today the vision that Howard Schultz had back then.

Schultz knew that he needed the full support from Starbucks employees; he gathered them on the roasting plant floor and re-emphasized his vision, and promised that he would neither let anyone down, nor leave anyone behind. He also pointed out that he wanted to include people in the decision-making process.

But this concern that he displayed towards the well being of Starbucks employees came a little late, as the unity and morale had already deteriorated; employee were cynical and felt unappreciated.

Fortunately, Howard Schultz understood early enough that one of the key success factors for a company to grow to higher grounds is to build a mutual respect between employees and management.

- Building the management team -
Schultz’s business plan called for the company to open 125 stores in the next five years (15 the first year, 20 the second, 25 the third, 30 the fourth, and 35 the fifth), and projected revenues of $60 million in 1992.

As the company was getting ready to shift gears and move faster, it was lacking an important ingredient: experienced management. Schultz was just learning what the job of a CEO was about, Dave Olsen had run only a single café for a number of years and had no experience in running a multi-store operation, and other Starbucks employees had only been managing or part of a few store operation.

Schultz made a wise decision then by hiring Lawrence Maltz, a 20 years business veteran with an eight years experience as president of a profitable public beverage company.

Lawrence took over the position of Vice President of operations, finance and human resources. At the same time, a new logo was created, and the Starbucks stores were remodeled as to make more visible the changes under way.

One major victory in rebuilding trust between employees and management was the Starbucks’ roasting plant union decertification in 1992, at the initiative of the employees.

Starbucks top management team was strengthen with people with extensive experience in managing and expanding retail chains.

By 1994, the four key executives - Howard Schultz, Dave Olsen, Howard Behar, and Orin Smith – were at the core of defining and shaping the company’s values, principles and culture.

The board of directors was staffed with people experienced in growing a retail chain and who could add valuable perspectives.
- Expansion and partnerships. Keeping the pressure -

Schultz learned that implementing stores outside their original area was not an easy win on all front. One needs to consider local trends, customer habits and local regulations. For instance, while expansion in the Pacific Northwest (from where Starbucks originated) was pretty easy, Chicagoans didn’t take Starbucks coffee as fast as expected, and some locations in Chicago were not appropriate.

It took several years for the Chicago locations to take grounds and become profitable, thanks to the price increases and the hiring of more experienced store managers.

When entering California, Howard Schultz took advantage of the trend setting of Los Angeles, and managed to have the Los Angeles Times to publish an article naming Starbucks the best coffee in America even before the first store opened there.

San Francisco proved to be more troublesome, due to an ordinance against converting stores to restaurant-related uses in certain prime urban neighborhoods. This ordinance was soon removed, opening the way for Starbucks to expand in the San Francisco Bay Area, despite a strong competition from Peet’s and local coffee shops.

Another key move from Schultz in expanding the business was to redefine the target, as the expansion was taking place. The execution was ahead of the plan, and in order to maintain a certain pressure to keep challenging the organization, the target was raised to 161 new stores.

Starbucks mail order business was re-centered: the target market was defined as well-educated, relatively affluent, well-traveled connoisseur interested in the arts and cultural events, and usually a loyal buyer of Starbucks’ products. This refocusing of the mail order targets also helped in identifying the location of the stores to be opened next.

Howard Schultz’s plan for expansion was based on three pillars: attracting a management team ahead of expansion needs, building a world-class roasting facility and a computer based system to keep track of sales in hundreds of stores.

Forecasting losses during the early years allowed him to keep investors confident, and by 1991, he had raised a total of $32.4 million.

Here was another smart move: the whole infrastructure was being built ahead of the growth, in order to be ready to sustain it.

In 1990, Starbucks became profitable again, and its profits had increased every year thereafter.

To sustain its growth strategy, Starbucks partnered with different companies.

In 1994, Starbucks entered into a joint venture with PepsiCo to create coffee-related products for mass distribution through Pepsi channels, and move the company into more mainstream market. This turned to be very successful with the introduction of Frappuccino in 1996.

By joining with PepsiCo, Starbucks managed to get into supermarkets while keeping its image of high quality products; Starbucks customers would be able to find their favorite cold coffee based drink anywhere.

Here, Schultz made another smart move by doing a market test on the US West Coast, where Starbucks was the strongest.

Another partnership with Dreyer’s Grand Ice Cream allowed Starbucks to enter in 1996 the ice cream sector with several coffee based products.

In 1995, Starbucks worked with Seattle’s Redhook Ale Brewery to create a stout beer with a shot of Starbucks coffee extract in it.
- Building the workforce -  

One of the challenges was to maintain a high level of employee performance, and to attract and retain young people, two-thirds of them working part-time at Starbucks.

To inform interested employees about updates on the company’s performance, answer questions, and to give them an opportunity to air grievances, Open Forums were held quarterly in every geographic region where the company did business.

In order for its customers to have a positive experience, Starbucks employees needed to be knowledgeable about the company’s products, be eager to communicate the company’s passion for coffee and have the skills and personality to provide upscale customer service.

During a board meeting, Schultz presented the employee’s request to have healthcare benefits extended to part-time workers as a core strategy to win employee loyalty and commitment to the company’s mission.

Improving the support to employees would build confidence, reduce turnover, and in turn would reduce hiring and training costs.

In order to attract and retain Starbucks employees, Schultz pursued another program from 1991 in the form of a stock option plan for all employees. The initial plan was based upon a 12% of the base pay, and the value of the shares was fixed at $6. The plan increased to 14% of the base pay in the following year, and shares went as high as $132 in 1996.

Board members were however concerned that granting shares to employees would dilute the value of the shares of investors who had put up hard cash.

Howard Schultz took the opportunity to nudge even further the employee-management relationship by calling “partners” all Starbucks people.

At the end of 1997, 8.7 million shares in outstanding options were granted at an exercisable price of $19.92, while the current stock price was $43.50.

Starbucks complemented with an employee stock purchase plan in 1995, by which employees could contribute up to 10% of their base earnings to purchases of the company’s common stock at 85% of the going stock price.

Recruitment and training has also been an important key success factor for Starbucks. “We want passionate people who love coffee . . . We’re looking for a diverse workforce, which reflects our community. We want people who enjoy what they’re doing and for whom work is an extension of themselves.” (as cited in Thompson and Gamble. “Starbucks Corporation” - http://www.mhhe.com/business/management/thompson/11e/case/starbucks-2.html)

Every employee received classes in the Starbucks Coffee School in San Francisco on coffee history, drink preparation, coffee knowledge, customer service and retail skills. The training was efficient at educating new employees to use the cash register, weigh beans and open the bag properly, capture beans without spilling them on the floor, and affixing labels at exactly one-half inch over the Starbucks logo.

Managers attended much deeper training, including the details of store operations, practices and procedure, information systems, and basis of managing people.

These plans, combined with an above average pay scale, allowed Starbucks to attract motivated people with above average skills and good working habits, and turned out to be successful: turnover rates were relatively low, and it was obvious that Howard Schultz’s approach, values and principles were having the intended effect on the company’s performance. This in turn had a positive effect on customers, and some of them asked if they could come to work at Starbucks.
**Mission statement, Values and Principles**

It's only in the early 1990s that the management understood that a mission statement would be a strong communication tool towards employees, customers, and investors. A mission review system was formed to make sure that the company lived up to the elements of this mission statement.

One of the key values that Howard Schultz was attached to promote was that the company would never stop pursuing the perfect cup of coffee. Specifically, Starbucks would never add chemical flavoring to its coffees, and would not make supermarket sales because of their use of plastic bags that would compromise the quality of Starbucks coffees.

However, in 1989, Schultz fell in the same trap as did Baldwin and Bowker years ago: resisting changes suggested by one of their employees. Customers have requested that nonfat milk be proposed, and it took one of the store manager's persistence to convince Starbucks management to do a market test.

This event signaled another turn in Starbucks history: Schultz and the management team had to surrender somehow to what their customer's perception was with regard to the company's product quality. Schultz remembered that Starbucks customers were “voting with their wallet”, and by 1997, about half of the lattés and cappuccinos were made with nonfat milk.

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**Starbucks Mission Statement:**

*Establish Starbucks as the premier purveyor of the finest coffee in the world while maintaining our uncompromising principles as we grow. The following six guiding principles will help us measure the appropriateness of our decisions:*

- Provide great work environment and treat each other with respect and dignity
- Embrace diversity as an essential component in the way we do business
- Apply the highest standard of excellence to the purchase, roasting, and fresh delivery of our coffee
- Develop enthusiastically satisfied customers all the time
- Contribute to our communities and our environment
- Recognize that profitability is essential to our future success.

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**Innovation**

Since the beginning, innovation has been a constant value at Starbucks: Schultz introduced the place-like-home between the home and the office, where people would gather around quality coffees and teas, and later on research and development efforts were conducted with partners such as PepsiCo for the cold Frappuccino drink, for the coffee flavored ice cream with Dreyer’s and for coffee flavored beer with a Seattle based brewery.

Starbucks formed a “stores of the future” team in 1995 to study the next generation of store design; "an authentic coffee experience that conveyed the artistry of espresso making, a place to think and imagine, a spot where people could gather and talk over a great cup of coffee, a comforting refuge that provided a sense of community, a third place for people to congregate beyond work or the home, a place that welcomed people and rewarded them for coming, and a layout that could accommodate both fast service and quiet moments."


The team came up with four templates, one for each of the four stages of coffee making, and combined colors, lighting scheme and materials. They also created the *brevebar*, a store-within-
a-store for supermarkets or office-building lobbies, and the *doppio*, a self-contained 8-square-foot space that could be moved from spot to spot. These innovations allowed Starbucks to significantly reduce the store-opening costs and match them with the sales that each store format would allow.

Starbucks product line was also the display of its innovation capabilities. The company stores had offered a choice of regular or decaffeinated coffee beverages, Italian-style espresso drinks, together with a wide selection of fresh-roasted whole-bean coffees.

Starbucks added a selection of fresh pastries and other food items like sodas, juices and coffee-related hardware and equipment like the *Starbucks Barista home espresso machine*.

The company added coffee mugs, together with special jazz and blues CD compilations of the music that was played in stores.

- **Quality matters** -

Schultz always kept in sight the quality of the products and services, and the perception of it from the customer’s point of view. Strict quality control was implemented all along the coffee process. Each store detail (fixtures, merchandise displays, colors, artwork, banners, music, and aromas) was closely studied to enhance the mood and ambience of the store, and that it reflected the personality of the community and the neighborhood.

Starbucks banned smoking and asked employees to refrain from wearing perfumes or colognes, and prepared foods were covered in order to keep the coffee aromas pure.

The company was recognized for its sensitivity to neighborhood conservation with the Scenic America’s award for excellent design and "sensitive reuse of spaces within cities."

The company designers came up with artwork for commuter mugs, and T-shirts were created along with different cities personality.
- **Expansion strategy** -

In 1992 and 1993, Starbucks developed an expansion strategy based on targeting areas with favorable demographic profiles together with the company’s infrastructure to support and service them.

For each region, a large city was selected to serve as a hub where a team would support the goal of opening 20 or more stores in the first two years.

One of the key success factors in this operation was to recruit professionals with extensive operating and marketing experience in chain-store retailing as new zones vice presidents.

This strategy was also built upon the growing reputation of the Starbucks brand, which, in some instances, had reached new markets even before stores opened.

Another key success factor in the expansion strategy was the real estate team which had a sophisticated system allowing Starbucks to identify the most attractive individual city block and the exact target store location.

In 1991, the company had formed a group to create a store development process based on a six-month opening schedule. Each store was to be different in shape and size, but would convey the appropriate image and character, contributing to strengthen the company’s reputation and image throughout the regions being expanded into.

Cost reduction was achieved by centralized buying, by standard contracts development and fixed fees for certain items, and by consolidated work under contractors with good cost-control practices.

Starbucks product supply was also a key in a successful expansion.

As another differentiating factor, the company purchased coffee on a negotiated basis at a substantial premium above commodity coffees; this allowed for Starbucks to build trust with producers and obtain top-notch coffee beans from producing countries.

In order to secure an adequate supply, the company entered into fixed-price purchase commitments when available, and purchased coffee futures contracts in other cases to provide price protection.

By this approach, Starbucks intent was to contain costs and avoid price hikes in the stores that would have a devastating effect on the company’s image.

Starbucks expansion strategy also relied on a limited number of licensing agreements for areas where it did not have the ability to open its own outlets.

Licensees such as Marriot Host International and Aramark allowed opening of Starbucks stores respectively in airports and university campuses.

Others like Horizon Airlines and United Airlines had Starbucks coffees served on commercial flights, while agreements with Nordstrom’s, Barnes and Noble and Well Fargo opened even more opportunities.

In 1997, the specialty sales division of Starbucks generated sales equal to 12.2% of total revenues.

The company’s international expansion started in 1995, and was based on two strategies: to provide licenses or to create a joint venture with a reputable and capable local company with retailing know-how in the target host country.

*Starbucks Coffee International* (SCI) was created in 1995 to coordinate the international expansion, which started in Japan, Hawaii, Singapore, Philippines, Taiwan and Korea.

Starbucks expansion strategy was well thought: the offensive was to take place in the Pacific Rim in order to gain momentum and strength, far away from Europe and Latin America where coffee shops competition is very strong.
**IPO and Stock performance**

Up until 1992, Starbucks had built its foundation in order to sustain a future expansion in a growing market: the Specialty Coffee Association of America had predicted that the number of coffee cafés in the US would rise from 500 in 1992 to 10,000 in 1999, and Starbucks was ready to participate in it.

The strength of the company, together with promising market forecast has lead Starbucks to one of the most successful IPO (Initial Public Offering) of 1992. By going public, Starbucks would get funding to fuel its expansion strategy over the years to come. From $5.50 in 1992, Starbucks common stock price went up to $25 in 2001, and is today at $58.

In order to maintain the proportionate equity among shareholders, Starbucks stock was split four times (1993, 1996, 1999 and 2001). As the share value increased, these split also prevented high prices from deterring small investors.

Starbucks stock growth (in blue on the chart) has always been above the average beverage industry stock growth (in green on the chart).

**Financing**

Until 1996, Starbucks avoided debt, and financed its growth entirely with equity capital and profits, reducing overall costs. This was made possible by the fact that the market growth allowed for the company to grow at its own pace without major threat from competitors.

But as the coffee shops market expanded, the need for high volume financing lead Schultz to accept debt as a legitimate financing vehicle starting from 1996.

Starbucks financial statements show that, as the number of stores increased, the revenue increased in the same range; this is typical of an infrastructure which has been well planned for growth:

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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total stores</td>
<td>165</td>
<td>272</td>
<td>425</td>
<td>676</td>
<td>1006</td>
<td>1381</td>
</tr>
<tr>
<td>Total stores change</td>
<td>65%</td>
<td>56%</td>
<td>59%</td>
<td>49%</td>
<td>37%</td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>103,000</td>
<td>176,000</td>
<td>284,000</td>
<td>465,000</td>
<td>696,000</td>
<td>966,000</td>
</tr>
<tr>
<td>Revenue change</td>
<td>71%</td>
<td>61%</td>
<td>64%</td>
<td>50%</td>
<td>39%</td>
<td></td>
</tr>
</tbody>
</table>
By turning to debt, Starbucks managed to fuel its major expansion stages: first across the US in 1992-93, then overseas starting in 1995:

<table>
<thead>
<tr>
<th>Year</th>
<th>US Expansion</th>
<th>Overseas expansion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets</td>
<td>91,000</td>
<td>201,000</td>
</tr>
<tr>
<td>Total assets change</td>
<td>121%</td>
<td>15%</td>
</tr>
<tr>
<td>Long term debt</td>
<td>1,360</td>
<td>82,000</td>
</tr>
<tr>
<td>Long term debt change</td>
<td>5929%</td>
<td>-2%</td>
</tr>
</tbody>
</table>

Finally, the high initial Starbucks’ P/E (Price/Earning) ratio shows that investors had a high degree of confidence in the company in the early years of its public life (1992 and early 1993). Its P/E ratio then decreased gradually until 1995 to stabilize around 60 where it stands today.

<table>
<thead>
<tr>
<th>Year</th>
<th>Stock common value</th>
<th>Stock value change</th>
<th>P/E Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock common value</td>
<td>5</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>Stock value change</td>
<td>40%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>P/E Ratio</td>
<td>130</td>
<td>93</td>
<td>60</td>
</tr>
</tbody>
</table>

**B.3) Starbucks historical growth analysis**

Starbucks historical growth relied on a blend of authentic coffee shop atmosphere to attract consumers, associated with the development of a sound management and operation infrastructure ahead of its revenue growth path.

It is a quality-driven organization, focused on pleasing its customers with a great experience, using psychographic segmentation. Starbucks understood soon enough that consumers are rational in the sense that they choose the market basket -or more generally, the course of action- that is most to their liking; in the case of coffee and tea consumption, consumers are looking for superior quality products delivered in the appropriate atmosphere and according to their lifestyle or their activity at the time of consumption.

The carefully crafted strategy is based on an accurate product positioning and target market. Defining early on Starbucks business as a social gathering place helped Howard Schultz to visualize a long-term growth opportunity, in a market much wider than purely the coffee market. Starbucks strategy to saturate rapidly key geographic areas was (and still is) very instrumental in neutralizing its local competitors, especially in an industry with low entry barriers. Starbucks competitive advantage is not limited to the product, but is extended to its expansion capability as well. Superior people recruitment, training and management also gave Starbucks a significant advantage over its competitors.

The value chain was well identified since the very beginning, and was kept consistent all along the growth path (for instance the store location choice and installation is a value item in the chain, leading Starbucks to create Real Estate Group to support it). Continuous improvement has been a constant at Starbucks, at all levels (stores organization and design, coffees and teases).

All the main external forces that constitute the marketing environment are addressed (economic, political, legal, social, institutional, technological, and competitive factors), and in many cases Starbucks knew how to leverage them to its advantage.
Setting the perception of the product at a high quality level gave the company more negotiating power for store implementation; local authorities of small or low-image regions are asking for Starbucks stores to open in order to improve their image.

Starbucks implemented a Community Relations Project in the form of the Starbucks Foundation in order to enhance community relations and reinforce a positive image of the organization.

The company is an example of vertically integrated organization; the supply chain goes from the agreements with the producers to the delivery to consumers. Starbucks organization is an M-Form type of structure, better suited to its strategy of words-of-mouth advertisement (one single company brand all the way through).

Another key success factor in the company’s steady and rapid growth is its functionally organized marketing structure to address all aspects of its expansion (real estate group, store development group, retail operation group).

Howard Schultz’s vision matched with consumers expectations, and he managed to attract early on key people who would help overcome his weaknesses (like the hiring of Dave Olsen, who knew how to form and communicate a vision, raise money, find good store locations, build a brand name and plan for growth).

The successful growth has been orchestrated by duplicating a proven recipe for each target region and store:
- maintain a deep knowledge of the product,
- carefully monitor the quality of the product,
- carefully chose the stores locations,
- recruit only knowledgeable management members at all levels,
- maintain a high level of employee performance,
- match the store capabilities with the store location,
- adopt aggressive growth tactics to maintain pressure and stay ahead of competition,
- avoid over-mediatization to prevent competitors early counteractions,
- leverage and grow the Starbucks brand through the introduction of new products and the development of new distribution channels.

Using this approach, the company managed to stay ahead of the game since the beginning.
Starbucks success is based upon a framework of Four A's (as described by Irina Ganzha, Marketing Seminar of Spring 2000, Goizueta Business School, Emory University):

- **Acceptability:**
  Starbucks coffee shop was a new concept for US consumers, and filled the gap between family and work. The Starbucks Experience was defined as “be yourself”, whether doing individual activities, or socializing with friends. The high quality of the products and services together with a broad range of products (coffee, teas, other products related to their use) increased the level of acceptance from the consumers. A key factor in developing acceptability was to educate the consumers to the quality of the products.

- **Affordability:**
  Starbucks’ genius was to redefine the meaning of affordability regarding coffee. Target consumers were identified with regards to their living environment, level of income and education. They were convinced to pay premium prices for the experience, service and quality they were getting. The company was able to capture the changing consumer behavior since the 1980’s: more out-of-home entertainment, more self gratification from consumers toward a good movie, a good glass of wine and a good cup of coffee. By increasing the perceived value of the product in the eye of the consumer, Starbucks was able to raise its prices while keeping the product affordable. Creating brand loyalty through quality and innovation was also an important factor in decreasing the price elasticity of this commodity product.

- **Availability:**
  The company's availability strategy relies on two approached driven at the same time: horizontal expansion and vertical growth. The horizontal expansion of Starbucks was planned since its very beginning, and consists of increasing the number of stores (either by ownership, by licensing or by specialty sales). Stores are clustered in the prime locations to maximize their market share in areas identified as having the highest volume potential. This in turn allows building a regional reputation (low profile regions and rural areas see Starbucks as a status symbol that upgrades the area’s image). The vertical growth strategy consists in creating a whole range of coffee drinking occasions such as in-store, on-the-go, at home, at work and travel, and by penetrating consumption places like offices, hotels, restaurants, catering services, campus cafés and home (by mail and online distribution).

- **Awareness:**
  While small coffee shops would benefit from local awareness, Starbucks leveraged its size and location strategy to reach high brand awareness, mainly by word-of-mouth. Another way that Starbucks increases awareness is through agreements with leading retailers, wholesalers, restaurants, airlines, bookstores to carry Starbucks coffee, associating Starbucks brand with the high quality and premium image of its partners. Finally, awareness was completed by selling coffee related and unrelated high quality items like coffee-makers, mugs, stationary and souvenirs bearing the Starbucks logo.
The company web site publishes the following statements:

While the Net Revenues increased steadily at rates ranging from 63% in the early years to 30% lately, following the growth of the store numbers, the Net Earnings experienced a bumpy ride, ranging from 156% to 46%, with a low at -7% during the 2000 economic downturn.

As the company was expanding overseas, the store sales growth experienced a decline (1996-1999, then 2001-2003), probably due to adjustments needed in the infrastructure to face the international expansion phases.
C- Starbucks: Present  

- Snapshot -  

Starbucks is today a $5.3 billion business operating in 30 countries in the service sector of the restaurant industry. The company is today the only global chain in a commodity market originally dominated by single or small chain retailers. The market is characterized by a global demand for the core product (coffee). Due to the high price that the company charges its customers for, demand for Starbucks’s coffee is more price-elastic than demand for “coffee”, which is more elastic than the demand for “beverages.” (coffee drinkers can easily switch to other brands of coffee, and to other beverages). Proposing substitutes to coffee allows Starbucks to be less sensitive to the price elasticity of demand for coffee. As of December 2004, a total of 8,337 stores were in operation around the world, the US accounting for 75% of them, according to the company’s web site.

The Company’s business is subject to seasonal fluctuations, and significant portions of its net revenues and profits are realized during the first quarter of the Company’s fiscal year, which includes the December holiday season.

About 30 million customers visit a Starbucks cafe each week, according to the company. "We continue to believe that the North American market is much, much larger than anyone is giving us credit for," Chief Executive Orin Smith told analysts during a conference call. "Frankly, we don't have enough stores in the market right now."

“We’re not a mass marketer. This business is based on repeat purchase and loyalty. Given that we don’t do advertising or traditional marketing, we depend very much on the in-store experience and building loyalty that way.” says Peter Maslen, president of Starbucks Coffee International.

Since the beginning, Starbucks has been loyal to its approach of spending very little money in advertising, preferring to build the brand cup by cup with customers, and depend on word-of-mouth and storefronts appeal.

“The essence of Starbucks is not about the coffee, although it’s great coffee. It’s about the coffee-drinking and the coffee house experience”, says Hayes Roth, vice president of marketing at Landor Associates, a consultancy that has advised Starbucks on branding strategy.

In an effort to demonstrate corporate responsibility, Starbucks started contributing in 1991 to CARE (a worldwide relief and development organization that sponsored health, education, and humanitarian aid programs in most of the Third World countries where Starbucks purchased its coffee supplies).

The Starbucks Foundation was created in 1997 and is actively engaged in the support of local community programs that promote youth leadership through the power of literacy and respect for diversity.
- **Financial analysis** -

Some of the company's historical ratios show departure from the industry average (as cited in "Financial Analysis, Starbucks vs. Java the Hut", Starbucks Project from Gregory Tabar [http://www.tabarsphere.com/Projects/Starbucks/index.htm]):

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Starbucks outlook (1999-2001)</th>
<th>Industry average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beta</td>
<td>1.24</td>
<td>0.51</td>
</tr>
<tr>
<td>Cost of Capital</td>
<td>10%</td>
<td>8%</td>
</tr>
<tr>
<td>Market Rate</td>
<td></td>
<td>6%</td>
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<td>10.55</td>
<td>2.23</td>
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<tr>
<td>Net Profit Margin</td>
<td>7%</td>
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<tr>
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<td>58%</td>
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<td>4.46</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>1.33</td>
<td>2.25</td>
</tr>
<tr>
<td>Asset Turnover</td>
<td>1.19</td>
<td>1.49</td>
</tr>
<tr>
<td>Days Receivable</td>
<td>11.49</td>
<td>32.19</td>
</tr>
<tr>
<td>Inventory Days</td>
<td>69.36</td>
<td>43.19</td>
</tr>
<tr>
<td>Payable Days</td>
<td>33.06</td>
<td>31.93</td>
</tr>
<tr>
<td>Operating Cycle</td>
<td>80.85</td>
<td>75.37</td>
</tr>
<tr>
<td>Cash to Cash</td>
<td>47.79</td>
<td>43.45</td>
</tr>
<tr>
<td>Return on Asset (ROA)</td>
<td>9%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Comments on historical ratios:

- Starbucks stock appears to be more volatile than the general stock market (Beta>1), and much more volatile than the industry.
- Its Cost of Capital is a little higher than the average of the industry, an indication that the level of risk for the company is higher than the industry average.
- The Return on Equity (ROE) is higher than the rest of the industry and indicates a better than average investment for this industry.
- The Market to Book ratio is more than 4 times that of the rest of the industry, indicating that Starbucks operates on the high growth side.
- Its Profit Margins (both Gross and Net) are higher than the industry, a sign of good financial health.
- The Financial Leverage goes along with the rest of the industry, and the Interest Coverage, much higher than the industry, indicates a strong ability of the company to meet its interest payments on outstanding debt.
- Starbucks appears to get payment from its customers sooner than the rest of the industry (Days Receivable much lower), while Days Payable are comparable.

Starbucks Corporation appears strong today, with financial parameters well above the average of the industry. Financial analysts recommend to either hold on to the stock (53%), or buy (40%):

<table>
<thead>
<tr>
<th>Starbucks Stock (SBUX)</th>
<th>Recommendation (December 2004)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Source: Yahoo Finance and Vanguard)</td>
</tr>
<tr>
<td>Strong Buy or Buy</td>
<td>40%</td>
</tr>
<tr>
<td>Hold</td>
<td>53%</td>
</tr>
<tr>
<td>Strong Sell or Sell</td>
<td>6%</td>
</tr>
</tbody>
</table>
- **Competition** -

Hoover Online (http://www.hoovers.com/) lists three major companies competing with Starbucks, plus a list of 21 other competitors:  
*Caribou Coffee* owns and operates the second largest non-franchised coffee chain in the US (behind Starbucks), with more then 290 stores in nine states.  
* Diedrich Coffee* is the second coffeehouse company (behind Starbucks) with 515 coffeehouses in the US and 13 in other countries.  
* Dunkin’ Brands* (formerly Allied Domecq Quick Service Restaurants) franchise more than 12,000 quick-service eateries in the world, including Dunkin’ Donuts, Baskin Robins and Togo’s. Other retail companies like AFC Enterprises, New World, Panera Bread Co. and Tulley’s are also competing against Starbucks.  

In Asia, five major companies compete with Starbucks (as cited by Valerie Darguste, Ana Su, Ai-Lin Tu, and Peggy Wei of Stern School of Business at New York University and Sonia Ketkar of the Fox School of Business and Management at Temple University - 2003):  
* Spinelli Coffee Company:* licensed by Equinox, a joint venture between Golden Harvest and Singapore Technologies Industrial Corp.  
* Suntec Dome Holdings:* modeled on European, with a growth strategy based on expanding into several Asian countries (Malaysia, Indonesia, Thailand, Hong Kong and China)  
* Coffee Club:* a sixty years old trading company which opened its first outlet in 1991.  
* Coffee Connection:* the latest and trendier incarnation of Suzuki Coffee House, started in 1980.  
* Burke’s Coffee:* a Seattle-style café in Singapore.  

Other international competitors like *Java the Hut* (http://www.javathehut.co.uk/) propose online coffee beans and equipment.

Counteracting competition, Peter Maslen, president of Starbucks Coffee International says “It’s very easy to copy the superficiality of the brand; in other words, the look and feel of the store, but it’s very hard to get beyond a few stores and retain the experiential part of our brand. The most important thing is how welcome people feel and the connection they make. It’s really a contradiction in terms – intimacy on a mass scale. But Starbucks is a very intimate brand.”

- **Macro environment** -

In the US, Starbucks evolves in a macro environment characterized by an aging population, increasingly diverse with significant Hispanic origins. Although the US per capita coffee consumption is on the rise (with specialty coffee consumption increasing as well), the income is on the decline, and the gap between the “haves” and the “have nots” is widening. The disposable income is at risk in the current economy, and consumer spending on the decline.  

Asia sees a high growth in disposable income, and increased Western beverages consumption. European macro environment is characterized by an overall sluggish economic growth; disposable income increases in certain countries, while it decreases in others.  

"*Europe is losing out in terms of growth and living standards,*" said Erkki Liikanen, the European Union commissioner responsible for enterprise policy. He blamed the situation on low employment levels and low productivity, particularly among the union’s biggest members, France, Germany, Italy and the United Kingdom. "*The big EU member countries have not been performing well,*" he said.  

On a global scale, a rampant international coffee crisis (overproduction, rising stocks, declining prices, elimination/neglect of coffee farms, further commoditization of specialty coffee) may result in a threat to supply of specialty coffee.
### SWOT analysis

<table>
<thead>
<tr>
<th><strong>Strengths</strong></th>
<th><strong>Weaknesses</strong></th>
</tr>
</thead>
</table>
| - Product diversification  
- Established logo, developed brand, copyrights, trademarks, website and patents  
- Company operated retail stores, International stores (no franchise)  
- High visibility locations to attract customers  
- Valued and motivated employees, good work environment  
- Good relationships with suppliers  
- Industry market leader  
- Globalized  
- Customer base loyalty  
- Product is the last socially accepted addiction  
- Widespread and consistent  
- Knowledge based  
- Strong Board  
- Strong financial foundation | - Size  
- Lack of internal focus (too much focus on expansion)  
- Ever increasing number of competitors in a growing market  
- Self cannibalization  
- Cross functional management  
- Product pricing (expensive) |

<table>
<thead>
<tr>
<th><strong>Opportunities</strong></th>
<th><strong>Threats</strong></th>
</tr>
</thead>
</table>
| - Expansion into retail operations  
- Technological advances  
- New distribution channels (delivery)  
- New products  
- Distribution agreements  
- Brand extension  
- Emerging international markets  
- Continued domestic expansion/domination of segment | - Competition (restaurants, street carts, supermarkets, other coffee shops, other caffeine based products)  
- US market saturation  
- Coffee price volatility in developing countries  
- Negative publicity from poorly treated farmers in supplying countries  
- Consumer trends toward more healthy ways and away from caffeine  
- Fragile state of worldwide production of specialty coffees  
- Alienation of younger, domestic market segments  
- Corporate behemoth image  
- Cultural and Political issues in foreign countries |

**Key problems:**
- Perils of expansion; there is a risk of strategic myopia.
- Due to its size, Starbucks becomes a less special place for employees.
- The quality of customer service decreases.
- Rampant crisis in the coffee industry.
- Perception of being a bully may impair foreign expansion capabilities.
Fortunately enough (for democracy), not everyone shares the perception of Starbucks as being a compassionate employer and a dedicated and loyal citizen of the world.

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

- “The vast majority of the coffee is grown using underpaid third world labor”
- “Starbucks is spreading across the world like a virus, infecting cultures with their formula of what a coffee shop should be”
- “They are everywhere”
- “They have predatory business practices. Common practices are things like paying landlords to not renew leases for coffee shops so that they can move in”
- “They sell fake corporate responsibility”
- “Their coffee is always bitter”
- “The gross profit margin per store is, on average, 59.1%, therefore there is plenty of wiggle room for the company to pay more than a dollar a pound for coffee. (read: livable wage for their slave labor)”
- “Faux ecologic responsibility”
- “False employee benefits. They give part time workers (20 hours per week) health insurance. However, I have received hundreds of emails from employees that consistently receive 19.75. 15 minutes shy of earning those costly benefits”
- “What they sell is incredibly unhealthy. Get the nutritional information, from their website it is appalling. The Caramel Pecan Sticky Roll (which has more fat than a Big Mac) or even better (worse), the Eggnog Latte are so bad for you it is astounding”

Further on this same web site, disappointed employees vent their frustration, while others, apparently more fortunate, react by praising the company they work for.

Like other American firms such as McDonald’s, Starbucks is finding that global fame carries a price. Growth is sometimes seen as corporate colonialism. An American company is often seen as an evangelist of all things American. The international expansion of Starbucks is seen as the outright hijacking of foreign cultures. "It’s very American ... and is seen as this very aggressive attempt to grow that business," said Greg Carpenter, the James Farley-Booz Allen Hamilton professor of marketing strategy at Northwestern University's Kellogg Graduate School of Management.

Starbucks haters' motivation seems to range from the sentimental (squeezing out independents) to the practical (increased parking and litter problems), to globalization evilness. Global Exchange (http://www.globalexchange.org/), the activist organization operating from San Francisco, California, claims that the company has been less than cooperative in implementing Fair Trade policies in the coffee market.

The resentment against Starbucks is for the least curious, as coffee shops have already existed for a long time around the world, and are known for having a minimal impact on the neighborhood. They don’t create any dependence on a proprietary technology, and a large corporation like Starbucks is probably no more exploitive than any other large corporation buying commodities from lesser developed markets.
In Canada, for instance, there is a Tim Hortons outlet approximately every 500 feet, and around 2,300 stores feeding a nation of 32 millions Canadians, i.e. one store for 13,900 people there. Starbucks, with more than 5,500 stores nationwide in the US, goes by the average of one store for every 54,000 Americans. And yet, there doesn’t seem to be “Tim Hortons haters” in Canada.

What seems to bother people most is that Starbucks is not so much selling coffee, but a particular brand of lifestyle called the “Starbucks Experience”, a kind of philosophy highly susceptible to criticism.

In May 2004, Starbucks’ workers at the 36th and Madison store in Midtown Manhattan organized the first Starbucks Barista’s Union in the US, complaining that the starting age was not a living wage in the city.

Growing up a corporation is always challenging for everyone in the hierarchical chain. Some are just more passionate than others, and dedicate more of their energy to the goal. However, a corporation is made of people, with their own behavior and their weaknesses. Like in any large corporation, local management always needs to be scrutinized from time to time in order to avoid the temptation of abusing the system.

Although one cannot deny that Starbucks may take advantage of its position in certain circumstances, and entertain aggressive business practices, the general perception of the company is good and appears to have a positive impact on the society; wealth is created, trailing behind new jobs and discovering new talents, around the world.
D) Starbucks: Future

Although Starbucks profits have increased significantly over the years, there are reasons for the company to be vigilant. Sales are still growing rapidly, but the rate of growth is slowing at existing stores. Many analysts attribute this to store cannibalization, as Starbucks has been known to open stores within one block of each other in hopes of saturating the market. This approach may also exacerbate competition among close Starbucks stores and damage the company culture within the workforce, resulting in a decrease in employees’ performance. Growth has been hurt by poor merchandising efforts, which leaves many products, like mugs and coffee makers, on display for years.

- Financial perspective -

Starbucks intends to pour in millions of new shares as options to employees and managers. If approved by investors, this plan would push options-related dilution to more than 19% of outstanding shares, far above the level at which many institutional investors might be expected to balk.

"By some measures, the plan would essentially double the company’s options dilution. This just seems like it’s excessive potential dilution" says Kent Hughes, Managing Director of Egan-Jones Proxy Services, an advisory firm.

"The board has long believed that employee ownership in the company serves the best interest of all shareholders, by promoting a focus on long-term increase in shareholder value," answers Starbucks board of directors.

Pouring in so many additional stock options in an attempt to compensate employees and managers may be a sign of Starbucks getting ready for yet another major step in its expansion; the company has demonstrated in the past its ability to set up the infrastructure ahead of time in order to support an aggressive growth period. The risk here is that a slow down in growth, as some financial analysts predict, may disappoint employees who would see their stock option value less than expected.

Starbucks financial perspective may not be as bright as the company expects. The following two tables are excerpts from a project developed by Gregory Tabar (“Financial Analysis, Starbucks vs. Java the Hut”, Starbucks Project from Gregory Tabar http://www.tabarsphere.com/Projects/Starbucks/index.htm):

<table>
<thead>
<tr>
<th>Income Statement and Balance Sheet perspective (-&gt; 2006)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starbucks estimated consolidated Income Statement</td>
</tr>
<tr>
<td>Total Net Revenues</td>
</tr>
<tr>
<td>Gross Margin</td>
</tr>
<tr>
<td>Store Operating Expenses</td>
</tr>
<tr>
<td>Starbucks estimated consolidated Balance Sheet</td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
</tr>
<tr>
<td>Accounts receivable</td>
</tr>
<tr>
<td>Inventories</td>
</tr>
<tr>
<td>Property, Plant and Equipment, Net</td>
</tr>
<tr>
<td>Accounts payable</td>
</tr>
<tr>
<td>Long-Term debt</td>
</tr>
</tbody>
</table>
Starbucks Financial Ratios perspective (-> 2006)

<table>
<thead>
<tr>
<th>Starbucks Outlook</th>
<th>3 years historical</th>
<th>2005-2006 pessimistic</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beta</td>
<td>1.24</td>
<td>1.24</td>
<td>0.51</td>
</tr>
<tr>
<td>Cost of Capital</td>
<td>10%</td>
<td>10%</td>
<td>8%</td>
</tr>
<tr>
<td>Market Rate</td>
<td>6%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return on Equity (ROE)</td>
<td>19%</td>
<td>13%</td>
<td>13%</td>
</tr>
<tr>
<td>Market to Book Ratio</td>
<td>10.55</td>
<td>3.54</td>
<td>2.23</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>7%</td>
<td>5%</td>
<td>5%</td>
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<td>Gross Profit Margin</td>
<td>58%</td>
<td>45%</td>
<td>40%</td>
</tr>
<tr>
<td>Financial Leverage</td>
<td>2.09</td>
<td>1.56</td>
<td>1.98</td>
</tr>
<tr>
<td>Interest Coverage</td>
<td>17.10</td>
<td>11.09</td>
<td>4.46</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>1.33</td>
<td>1.16</td>
<td>2.25</td>
</tr>
<tr>
<td>Asset Turnover</td>
<td>1.19</td>
<td>1.54</td>
<td>1.49</td>
</tr>
<tr>
<td>Days Receivable</td>
<td>11.49</td>
<td>20.90</td>
<td>32.19</td>
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<tr>
<td>Inventory Days</td>
<td>69.36</td>
<td>34.24</td>
<td>43.19</td>
</tr>
<tr>
<td>Days Payable</td>
<td>33.06</td>
<td>59.36</td>
<td>31.93</td>
</tr>
<tr>
<td>Operating Cycle</td>
<td>80.35</td>
<td>55.15</td>
<td>75.37</td>
</tr>
<tr>
<td>Cash to Cash</td>
<td>47.79</td>
<td>-4.22</td>
<td>43.45</td>
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<td>Return on Assets (ROA)</td>
<td>9%</td>
<td>8%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Starbucks stock is expected to remain more volatile than the industry. The effect of increased international competition together with a saturation of the US market leads to anticipate the following:

- The Return on Equity (ROE), Gross and Net Profit Margins might decrease to align with the industry, which in turn might cause investors to turn to other more attractive earning vehicles,
- The Market to Book ratio might fall, indicating a slowdown in the company’s growth,
- A decrease in the Financial Leverage, bringing it below the industry average, may discourage new investors,
- The diminishing Interest Coverage would be a sign of a less profitable earning vehicle for investors,
- As Starbucks position may weaken, its power towards customers would deteriorate, showing in increased Days Receivable. Relationships with suppliers may also deteriorate due to higher pressure, as shown by increasing Days Payable.

While some believe that Starbucks business focus may shift (like its new venture with Hewlett-Packard to let customers burn CD from a selection of songs), this is unlikely to happen; Starbucks is likely to diversify, but not refocus.
- International expansion -

“Based on the company’s strong international growth, customers are voting with their wallet and buying Starbucks. We’re not taking our success for granted, we also understand that the burden of proof at times is on us given the fact that a lot is being written and there’s more sensitivity than ever before about America and American companies. These are the very early days for the growth and development of the company internationally. Clearly there’s a big world out there for Starbucks to expand in.” Howard Schultz says.

Operating in current volatile political or economic situations could introduce a lot of risk for the company, experts say. "It is typically the market leader that attracts the attention of activists," said Prashant Malaviya, associate professor of marketing at INSEAD business school in Fontainebleau, France. "Both because of people’s political views ... but also in countries where there is not so much a political backlash but where they may have messed up."

Starbucks further expansion in Asia should continue at a sustained rate because the region is full of emerging markets. Asian consumers’ disposable income is increasing as their countries’ economies grow, and most of all, people over there are open to Western lifestyles.

However, the company is likely to encounter difficulties in Europe due to fierce competition. The coffee culture in the Old Continent has deep roots, and the current political discord between the US and Europeans may exacerbate the already problematic anti-Americanism sentiment over there.

An American brand is very likely to face a strong resistance, and unless a new brand is created that matches with the European culture and perception, Starbucks’ growth will be slower in Europe than in Asia, and much slower than what it experienced in the US. For instance, many Europeans are still used to smoke when drinking coffee, which seems opposed to the original approach of Starbucks to ban smoking in their coffee shops; others would be looking for non-smoking coffee shops as a new developing trend.

Europeans associate coffee with Italy, and the most likely successful approach to the European expansion would be to propose coffee shops “al Italiano” or “il senso Italiano” (the Italian way), and come up with a new brand name with an Italian consonance.

Needless to say, the quality of the coffee served in European outlets will need to be as good as the local brands (i.e. better than the current Starbucks American coffee quality).
- **Recommendations** -

In an attempt to better address the current issues and strengthen its foundations, the following recommendations can be made:

<table>
<thead>
<tr>
<th>Recommended action</th>
<th>Potential related problem</th>
</tr>
</thead>
<tbody>
<tr>
<td>Focus on US domestic market: achieve saturation, and adjust store locations for optimum profits</td>
<td>Decreased profits due to cannibalization of US stores, and slowdown in international expansion</td>
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<tr>
<td>Motivate the employees and make them feel attached to the company: match the pay scale with the workload, install a reward for performance program to improve employee motivation, and a program of the “Corporate Ambassador Award” (an award for the best employee with regard to customer interaction and company support)</td>
<td>Increased costs</td>
</tr>
<tr>
<td>Strengthen the training program, and set an annual training program to include all key employees from across the world in Seattle; set an online training center for all employees</td>
<td>Increased costs</td>
</tr>
<tr>
<td>Appeal to the younger generations; run advertisement campaign (“it’s not your parent’s Starbucks”), and expand into colleges and universities</td>
<td>Younger generations may not be willing to pay a premium for a commodity. Need to develop new products as coffee is not a teenager’s favorite drink. Increased costs</td>
</tr>
<tr>
<td>Extend the contracts with coffee suppliers, and promote the commitments to origins program</td>
<td>Increased perception of large size corporation taking advantage of producers</td>
</tr>
<tr>
<td>Reduce the perception of a bully by not adopting techniques to keep competition out, rather show how they have elevated the “experience” above a commodity</td>
<td>Reduced aggressiveness may result in reduced performance on a commodity market and loss of market share</td>
</tr>
<tr>
<td>Remind consumers of community involvement (Starbucks Foundation), foster more local public service and give back to the community</td>
<td>Increased perception of a large corporation spreading over the world “like a virus”</td>
</tr>
<tr>
<td>Expand and enhance the existing network by targeting new markets and diversification</td>
<td>Risk of losing focus on the core business. Increased perception of a large corporation spreading over the world “like a virus”</td>
</tr>
<tr>
<td>Open up all levels to easy communication</td>
<td>Increased costs</td>
</tr>
<tr>
<td>Increase spending on advertising from 1% to 5%</td>
<td>Increased costs. Increased perception of a large corporation spreading over the world “like a virus”</td>
</tr>
<tr>
<td>Create a specific brand for European expansion, or acquire an already well established brand with still growth potential left</td>
<td>Increased costs. Unknown new brand may result in low acceptance level and slow growth</td>
</tr>
</tbody>
</table>
E) Conclusion
Starbucks strategy is fairly simple: increase the perception of high quality of a commodity product, adapt stores to the consumers’ lifestyle, and blanket areas completely, one after the other, even if the stores cannibalize one another business. The company’s approach cuts down on delivery and management costs, shortens customer lines at individual stores, and increases foot traffic for all the stores in an area. A typical Starbucks US customer stops by 18 times a month, much more frequently than in any other coffee shop. Even more amazing is that Starbucks has been generating this formidable growth from a commodity product, with virtually no marketing, spending just 1% of its annual revenues on advertising, while retailers usually spend 10%.

Critics on Wall Street believe that the US market will be saturated by 2006, while Howard Schultz restates that “Those who talk about saturation obviously don’t understand our business strategy.” There will be protectionism developing abroad as Starbucks gains market share, but as the company has already shown its ability to blend in a culture and a neighborhood, it won’t stop the expansion; at worst, it’ll slow it down, forcing the company to adapt, which it knows how to do already.

“The most important thing Starbucks must keep in mind is that no brand expands in a vacuum. Every brand is rooted in popular culture. That’s the difference between advertising and branding. Advertising grabs their minds; branding grabs their hearts.” says Rob Frankel, a branding consultant.

Starbucks demonstrated in the past its strength and ability to sustain growth even during recession, and while analysts believe that Starbucks growth will slow down with regard to its past, the company is here to stay.

Howard Schultz:
“We aren’t in the coffee business, serving people. We are in the people business, serving coffee”.
(Fortune Magazine, Vol. 149 No. 2)

Here is the point: forget about just the coffee.

From coffees to teas, to T-shirts, mugs, music CD, internet access, store locations and ambiance, Starbucks is a People Shop and there is indeed an ever growing market for this.
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