

## Starbucks: Schultz Serves Up a Turnaround

INSPIRED BY ITALIAN coffee bars, Starbucks CEO Howard Schultz set out to provide a completely new consumer experience. The trademark of any Starbucks is its ambience—where music and comfortable chairs and sofas encourage customers to sit and enjoy their beverages and, more recently, food and even wine. While hanging out at Starbucks, customers can use the complimentary wireless service or just visit with friends. The barista seems to speak a foreign language as she rattles off the offerings: Caffé Misto, Caramel Macchiato, Cinnamon Dolce Latte, Espresso Con Panna, or Mint Mocha Chip Frappuccino, among some 30 different coffee blends. Dazzled and enchanted, customers pay \$4 or more for a venti-sized drink. Starbucks has been so successful in creating its ambience that customers keep coming back for more.

Starbucks' core competency is to create a unique consumer experience the world over. The strategic intent was to create a "third place," between home and work, where people wanted to visit, ideally daily. Customers are paying for the unique experience and ambience, not for the cup of coffee. The consumer experience that Starbucks created is a valuable, rare, and costly to imitate intangible resource. This allowed Starbucks to gain a competitive advantage. Since 2000, Starbucks' revenues have grown 10-fold, from less than \$2 billion to some \$20 billion in 2015.

While core competencies are often built through learning from experience, they can atrophy through forgetting. This is what happened to Starbucks. Between 2004 and 2008, Starbucks expanded operations rapidly by doubling the number of stores from 8,500 to almost 17,000 stores (see Exhibit MC7.1). It also branched out into ice cream, desserts, sandwiches, books, music, and other retail merchandise, straying from its core business.

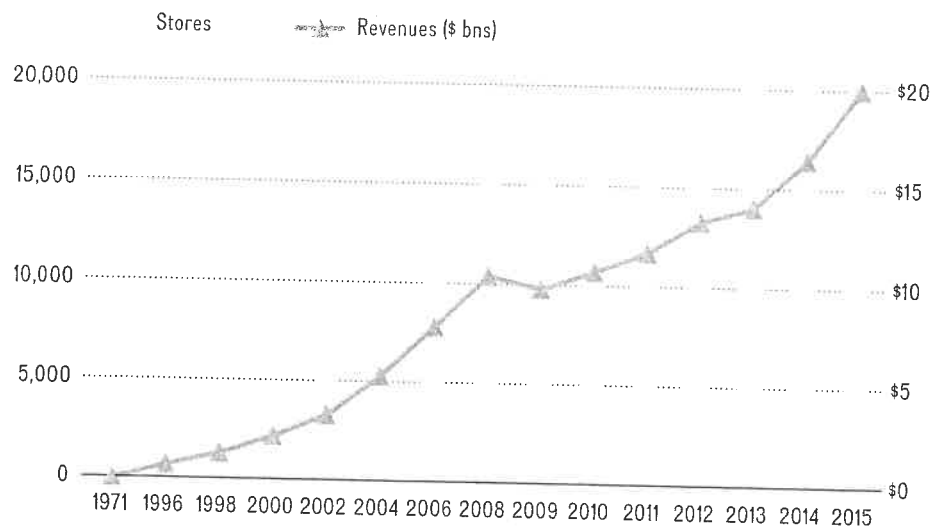
Trying to keep up with its explosive growth in both the number of stores and product offerings, Starbucks began to forget what made it unique. It lost the appeal that made it special, and its unique culture got diluted.



China represents a future growth opportunity for Starbucks, assuming it can transfer its core competency successfully.  
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For example, baristas used to grind beans throughout the day whenever a new pot of coffee had to be brewed (which was at least every eight minutes). The grinding sounds and fresh coffee aroma were trademarks of Starbucks stores. Instead, to accommodate its fast growth, many baristas began to grind all of the day's coffee beans early in the morning and store them for the rest of the day. New espresso machines, designed for efficiency, were so tall that they physically blocked interaction between baristas and customers. Although these and other operations changes allowed Starbucks to reduce costs and improve efficiency, they undercut Starbucks' primary reason for success—that going to Starbucks was not simply a stop for caffeine; it was a sensory experience.

Frank T. Rothaermel prepared this MiniCase from public sources. He gratefully acknowledges James Hoadley for research assistance. This MiniCase is developed for the purpose of class discussion. It is not intended to be used for any kind of endorsement, source of data, or depiction of efficient or inefficient management. All opinions expressed, all errors and omissions are entirely the author's. Revised and updated: August 20, 2015. © Frank T. Rothaermel.



Source: Depiction of data drawn from various Starbucks annual reports.

The negative impact of cost-reduction measures was underscored when Starbucks lost a blind taste-test to fast-food giant McDonald's. Among six coffees tested, Starbucks came in last. Even run-of-the-mill supermarket coffees sold in huge cans were rated higher. Some customers don't like Starbucks coffee and gave the chain the nickname "Charbucks"—because critics say that a lot of the coffee has an overly roasted quality, a dark and bitter taste.

To make matters worse, the global financial crisis (2008–2009) hit Starbucks hard. The first items consumers go without during recession are luxury items such as a \$4 coffee at Starbucks (see revenue drop in Exhibit MC7.1).

Coming out of an eight-year retirement, Howard Schultz again took the reins as CEO in January 2008, attempting to re-create what had made Starbucks special. He immediately launched several strategic initiatives to turn the company around. Just a month after coming back, Schultz ordered more than 7,000 Starbucks stores across the United States to close for one day so that baristas could learn the perfect way to prepare coffee. The company lost over \$6 million in revenue on that one day. This exacerbated investor jitters, but Schultz felt the importance of relearning

how to create a unique Starbucks experience was key to bringing back its unique corporate culture.

In 2009, Starbucks introduced Via, its new instant coffee, a move that some worried might further dilute the brand. In 2010, Schultz rolled out new customer service guidelines: Baristas would no longer multitask, making multiple drinks at the same time, but would instead focus on no more than two drinks at a time, starting a second one while finishing the first. Schultz also focused on readjusting store managers' goals. Before Schultz's return, managers had been given a mandate to focus on sales growth. Schultz, however, knew that Starbucks' main differentiator was its special customer experience. The CEO instructed managers to focus on what had made the Starbucks brand successful in the first place.

Although its earlier attempt to diversify away from its core business in the mid-2000s failed, under Schultz, Starbucks was able to successfully introduce food items. Attempting to drive more store traffic in other than the morning hours where customers need their daily caffeine shot, the chain has added baked goods, sandwiches, and other food items to its menu. To get more customers into its stores in the late afternoon and early evening—traditionally its slowest

time—Starbucks stores now offer items such as vegetables, flatbread pizza, plates of cheese, and desserts. It even introduced alcoholic beverages such as wine and beer, available after 4 p.m. Starbucks' goal is to double its revenues from food over the next few years and to be seen as an evening food-and-wine destination. To symbolize its transition from a traditional coffeehouse, Starbucks dropped the word *coffee* from its logo.

Schultz also pushed the adoption of new technology to engage with customers more intimately and effectively. Starbucks now uses social media platforms Facebook and Twitter to communicate with customers more or less in real time. Its highly successful Starbucks loyalty program has over 10 million regular users. Some 20 percent of all transactions in U.S. stores are now made using mobile devices. The latest tech innovation is a Starbucks app that allows customers to order and pay for drinks and food ahead of time, so that they can bypass standing in line and just need to pick up their order.

Finally, as the U.S. market appears to be saturated with some 12,000 stores, Schultz believes that Starbucks has a great growth opportunity by opening more cafés overseas. Starbucks is planning to have more than 3,000 stores in China by 2019, up from 1,500 in 2015. Starbucks also plans to double its number of cafés elsewhere in Asia to more than 4,000 in the next few years.

As the creator of Starbucks, however, Schultz enjoyed a degree of freedom that an ordinary CEO would not have had. Howard Schultz is to Starbucks much like Steve Jobs was to Apple. Schultz has the reputation and power of personality to implement a change that reduces operational effectiveness in favor of delighting customers. Schultz was able to orchestrate a successful turnaround, and with it Starbucks was able to gain and sustain a competitive advantage.

Since 2009, Starbucks' stock price has appreciated by over 1,000 percent, outperforming the Dow Jones Industrial Average by some 940 percentage points.<sup>1</sup>

#### DISCUSSION QUESTIONS

1. How did Starbucks create its uniqueness in the first place? Why was it so successful?
2. To be a source of competitive advantage over time, core competencies need to continuously be honed and upgraded. Why and how did Starbucks lose its uniqueness and struggle in the mid-2000s?
3. What strategic initiatives did Howard Schultz put in place to re-create Starbucks' uniqueness after his return in 2008? Detail each strategic initiative, and explain why a specific strategic initiative was successful, if so.
4. What makes Schultz a great strategic leader?
5. How is Starbucks trying to grow in the future? Do you think it will continue to be so successful? Why or why not?

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#### Endnote

<sup>1</sup> Between January 1, 2009, and August 20, 2015, Starbucks shares appreciated by 1,030 percent, while the Dow Jones Industrial Average appreciated by 91 percent.

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Sources: This MiniCase is based on: "Starbucks raises prices despite declining coffee costs," *The Wall Street Journal*, July 6, 2015; "Starbucks profit jumps, as revenue surges 18%," *The Wall Street Journal*, July 23, 2015; "Starbucks aims to double U.S. food sales," *The Wall Street Journal*, December 4, 2014; "Forty years young: A history of Starbucks," *The Telegraph*, May 11, 2011; "At Starbucks, baristas told no more than two drinks," *The Wall Street Journal*, October 13, 2010; "Latest Starbucks buzzword: 'Lean' Japanese techniques," *The Wall Street Journal*, August 4, 2009; Behar, H. (2007). *It's Not About the Coffee: Leadership Principles from a Life at Starbucks* (New York: Portfolio); Schultz, H., and D.J. Yang (1999). *Pour Your Heart Into It: How Starbucks Built a Company One Cup at a Time* (New York: Hyperion); "Five things Starbucks won't tell you," *The Wall Street Journal* video, <http://on.mktw.net/1UVStO6>; and <http://investor.starbucks.com>.