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Starbucks Corporation

January 2017. After sitting through another long executive meeting, Starbucks chairman and CEO Howard Schultz, now in his mid-60s, looked out the window to the beautiful Elliot Bay from the company's headquarters in downtown Seattle. As he watched the setting sun glisten off the water, he contemplated his second and, he hoped, final retirement when stepping down as CEO in April 2017. Although he retains the chairman of the board position, Schultz promised himself and investors that he would not interfere in the day-to-day business. Starbucks' new CEO is Kevin Johnson, who served as Schultz's Chief Operating Officer (COO), and second in command. Indeed, Howard Schultz was looking forward to retiring from the day-to-day pressure of running a $21 billion global company.

After Schultz first retired in 2000, Starbucks doubled its number of stores within a few years and implemented operational effectiveness measures to speed up customer service. At the same time, Starbucks' perceived customer experience tanked and its stock market valuation dropped by 75 percent between 2006 and 2008: Starbucks was in a downward spiral. Subsequently, Schultz came out of retirement in 2008 and initiated a successful turnaround. His struggles are captured well in the title of his *New York Times* bestseller: "Onward: How Starbucks Fought for Its Life without Losing Its Soul."[1] Since his return, Starbucks' stock price has appreciated by over 400 percent.

With more than 25,000 stores in 75 countries and $21 billion in annual revenues, Starbucks is the largest roaster and retailer of specialty coffee in the world.[2] In recent years, its stock had outperformed the broader market index by a wide margin (**Exhibit 1**), delivering handsome returns to investors. Nonetheless, Howard Schultz couldn't shake the nagging thought that he might be brought out of retirement yet again, should Starbucks' not be able to tackle the current challenges without him.

A Brief History of Starbucks

The first Starbucks opened in 1971 in Seattle's historic Pike Place Market, a popular tourist attraction. Jerry Baldwin, Zev Siegl, and Gordon Bowker, three friends from the University of San Francisco, learned the art of coffee roasting from Alfred Peet–founder of Peet's Coffee and Tea.[3] The three friends started Starbucks in order to sell freshly roasted coffee beans. They did not initially sell freshly brewed coffee, focusing exclusively on serving customers that demanded high quality coffee beans and equipment. The Starbucks founders bought out Alfred Peet to acquire Peet's Coffee and sold Starbucks to Howard Schultz in 1987, with a five-year non-compete agreement in the Bay Area.[4]

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HOWARD SCHULTZ

Howard Schultz was born in 1953 into a working-class family in Brooklyn, New York. Growing up, Schultz witnessed his father struggle with low-paying jobs that did not offer health insurance.[5] A talented athlete, Schultz played baseball, football, and basketball, eventually earning an athletic scholarship to Northern Michigan University in Marquette, Michigan, where he graduated with a bachelor's degree in communications in 1975. Schultz briefly worked in sales for Xerox before becoming general manager for Hammarplast, a coffee equipment manufacturer that supplied Starbucks with coffee filters. Schultz first visited Starbucks in 1981 to learn why his client was using so many filters. Impressed by his visit, Schultz left Hammarplast a year later and joined Starbucks in 1982 as Director of Operations and Marketing, at a time when Starbucks had only four stores.

In 1983, while on a business trip to Milan, Italy, Schultz was inspired by coffee bars that not only served high-quality espresso but also provided a vibrant daily social experience. The cafes served as a public gathering place for all facets of Italian society. Seeing similar potential for Starbucks in the United States to create a "third place" for social interactions between home and the office, Schultz convinced Starbucks owners to try selling espresso drinks in some stores. Schultz, however, was unable to motivate a company-wide rollout because the owners did not want Starbucks to expand into the restaurant industry.

Frustrated by Starbucks' founders' lack of enthusiasm for his vision, Schultz resigned from Starbucks in 1986 to pursue his own venture, founding Il Giornale coffee stores. Schultz approached 242 individual and institutional investors to raise capital for Il Giornale, over 200 of whom rejected his pitch.[6]

In 1987, the original founders sold Starbucks for $3.8 million to Schultz, who rebranded his Il Giornale coffee bars with the Starbucks name. As CEO of the new Starbucks, Schultz immediately began to transform the company from a niche coffee bean roaster to the beverage retailer we know today. He rapidly expanded the company across the United States and North America, opening its first store abroad in Vancouver, Canada, in 1987.[7]

On June 26, 1992, Starbucks had its initial public offering (SBUX), with shares closing well above the opening price after its first day of trading, representing a market capitalization of nearly $46 million.[8,9] Starbucks used its IPO funding to fuel domestic and international store growth (**Exhibit 2**), as well as a more diverse menu throughout the 1990s. Since its IPO, Starbucks has had six 2:1 stock splits, most recently in March 2015, and generated an annualized rate of some 24 percent in addition to dividend payouts that began in 2010.[10]

With the new millennium approaching in 2000, then 47-year-old Howard Schultz decided to retire. In a little more than a decade, Schultz had built the world's most successful global chain of coffee stores that was earning the highest revenue, income, and profit margin in the company's history.[11]

By 2008, Starbucks' fortunes had turned. Between 2004 and 2008, Starbucks expanded operations rapidly by doubling the number of stores from 8,500 to almost 17,000 stores (**Exhibit 2**). It also focused on improved operational effectiveness in order to achieve faster customer service. Moreover, it branched out into sandwiches, ice cream, desserts, books, music, and other retail merchandise. Starbucks was hit hard by the 2008–2009 financial crisis when many customers could no longer afford to pay Starbucks' premium prices. Although Starbucks' revenue had grown from $2.2 billion in

2000 to $9.4 billion in 2007 and increased its pre-tax profit margin from 7.4 percent to 11.2 percent over the same period, Starbucks was more and more dependent on opening new stores to support the flagging profitability of its existing stores.[12] With 17,000 stores already open in North America by 2007, it seemed that Starbucks was nearing saturation of existing markets.

After an eight-year retirement, Howard Schultz returned 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 a 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 loss exacerbated investor jitters, but Schultz felt that relearning how to create a unique Starbucks experience was key to bringing back its unique corporate culture.

Howard Schultz takes pride in the accomplishment of introducing coffee shops to mainstream North American society. An important element of a Starbucks's "third place" status is that each store is welcoming and comfortable.[13] During his eight-year hiatus, Schultz felt that that Starbucks was losing its unique ambience and customer experience. In 2007, Schultz wrote a memo to Starbucks' leadership bemoaning decisions that improved efficiency, economies of scale, and company growth at the cost of customer experience.[14] Even though revenues for the company were still growing, the projected trend did not look positive: growth in overall revenue and same-store sales were much smaller than in the previous year. The company had grown to over 17,000 stores by 2008, but its stock price was falling (**Exhibits 1 and 2**).

In 2008, Schultz presented a "transformation agenda" that included goals such as "ignite the emotional attachment with our customers," "...[make] each store the heart of a local neighborhood," "engage and inspire partners," among others.[15] These goals illustrate the emphasis that Schultz places on customer experience above the usual goals of leading the coffee industry, and becoming more innovative and more sustainable at the same time.

As part of the turnaround strategy, 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.

Attempting to drive more store traffic other than the morning hours where customers need their daily caffeine shot, Starbucks continued to diversify its menu. To get more customers into its stores in the later afternoon and early evening—traditionally its slowest time of the day—Starbucks stores now offer items such as vegetables, flatbread pizza, plates of cheese, and desserts. It even introduced alcoholic beverages such wine and beer, available after 4:00 pm. Starbucks' goal is to double its revenues from food over the next few years and also 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 like Facebook and Twitter to communicate with customers more or less in real time. Starbucks' highly successful loyalty program has over 10 million regular users. The latest tech innovation is a Starbucks app that allows customers to order and pay for drinks and food before reaching the store in order to pick up their order directly from the barista, allowing them to bypass standing in line. Nonexistent before 2011, some 21 percent of all Starbucks transactions in U.S. stores are now made through the Starbucks app.[16]

Social Responsibility and Activism

Howard Schultz has been quite active as well as controversial on both political and social issues. He has criticized the lack of affordable health care, decried political leaders for not doing enough to stimulate the U.S. economy, and promoted social causes within and through Starbucks. In August 2015, Schultz wrote a *New York Times* op-ed that read, in part, "I'm not done serving at Starbucks...Although we have built an iconic brand while providing even part-time employees with access to health care, free college education and stock options, there is more we can do as a public company to demonstrate responsible leadership."[17]

For many years, Starbucks has been in the forefront of advocating for social causes. In their own words, "Our focus is on ethically sourcing high-quality coffee, reducing our environmental impacts and contributing positively to communities around the world."[18] Under the leadership of Howard Schultz, Starbucks has supported numerous philanthropic and social causes, including same-sex marriage, gun control, racial, ethnic and income inequality, support for military veterans, and affordable access to healthcare and education. Schultz's humble beginnings[19] have been a factor in his decisions to use Starbucks to support low-income youth employment, provide health-care benefits and higher education to employees.

In 2008, Starbucks partnered with (RED)—a licensed brand that collaborates with the private sector in raising awareness and funds to fight HIV/AIDS in Africa—and has since contributed over $13 million.[20] In 2012, Starbucks joined a group of other corporations that publicly endorsed same-sex marriage in order to support the state of Washington's proposed legislation recognizing same-sex marriages.[21] At the annual shareholders meeting in 2013, Schultz explicitly rejected shareholder criticism of these social activist actions, saying, "You could sell your shares at Starbucks and buy shares in other companies."[22]

In 2013, Schultz again put Starbucks in the middle of a national debate by asking Starbucks customers in the U.S. to stop bringing weapons inside Starbucks stores.[23] The company previously had not taken a position on this issue and deferred to relevant state laws that regulate the open carry of weapons in public places. Starbucks' policy came to a head in Newtown, Connecticut when a group of local gun-rights supporters participated in a national gun-owners "Starbucks Appreciation Day" in August, 2013 – nine months after the deadly school shooting at the town's Sandy Hook Elementary School, where 20 children ages six to seven, and six adults were killed. The Newtown Starbucks store closed five hours early in response to the event.[24] The following month, Schultz wrote an open letter to Starbucks customers that cited Starbucks' status as a "third place" in American society as a reason to keep guns away from its premises, stating, "The presence of a weapon in our stores is unsettling and upsetting for many of our customers."[25]

In 2013, Starbucks committed to hire at least 10,000 military veterans and their spouses by 2018.[26] In 2015, Schultz led Starbucks, Microsoft, Walmart, Lyft, and other corporations to jointly announce a commitment to hire 100,000 young African-Americans and Latinos from low-income communities by

2018.[27] Additionally, Starbucks worked with community-development financial institutions to launch the Create Jobs for USA program, which collects donations from customers, employees, and others to increase available funds for community business lending.[28]

In 2014, Starbucks announced that it would pay the full tuition cost for its employees, called "partners," to earn a bachelor's degree at Arizona State University's online programs.[29] In early 2015, Starbucks encouraged its partners to engage with customers in conversations about racial issues. As part of the "Race Together" campaign, employees wrote #RaceTogether on customer's coffee cups to initiate a conversation. Schultz said at the time, "we at Starbucks should be willing to talk about these issues in America...not to point fingers or to place blame, and not because we have answers, but because staying silent is not who we are."[30] The campaign was dropped in response to customer backlash, both in stores and on social media—customers did not want to engage in this type of conversation while getting their daily cup of coffee. Moreover, some argued that the baristas would not have the experience or training to handle such conversations.[31]

Starbucks in 2017

As of early 2017,[32] Starbucks products are offered in over 25,000 company-operated and franchised stores as well as in other retail locations globally, including colleges and universities, offices, grocery and convenience stores, hotels, and airports.[33] With stores in 75 countries,[34] Starbucks is the largest roaster and retailer of specialty coffee in the world. In addition to coffee, Starbucks products also include tea and other beverages, and a variety of fresh food items. Starbucks brands include Starbucks Coffee, Teavana®, Tazo®, Seattle's Best Coffee®, Evolution Fresh, La Boulange and Ethos®.

Starbucks employs approximately 254,000 people around the world. In the U.S., Starbucks employs 170,000 people with 162,000 working in company-operated stores and the remainder in support facilities, store development, and roasting, manufacturing, warehousing and distribution operations. Approximately 84,000 employees work outside of the U.S., with 81,000 in company-operated stores and the remainder in regional support operations.[35]

Starbucks is organized based on geography into four divisions: 1) Americas, comprised of the United States, Canada, and Latin America; 2) Europe, Middle East, and Africa (EMEA); 3) China/Asia Pacific (CAP) and 4) Channel Development. Channel Development includes roasted whole bean and ground coffees, premium Tazo® teas, Starbucks- and Tazo®-branded single-serve products, a variety of ready-to-drink beverages, such as Frappuccino® beverages, Starbucks Doubleshot® espresso drinks, Starbucks Refreshers® beverages, and other branded products sold worldwide through grocery stores, warehouse clubs, specialty retailers, convenience stores, and U.S. foodservice accounts. Starbucks also has non-reportable operating segments, including Teavana®, Seattle›s Best Coffee®, Evolution Fresh, and Digital Ventures, which are combined and referred to as All Other Segments. Revenues as a percentage of total net revenues for fiscal 2016 were as follows: Americas (69 percent), CAP (14 percent), EMEA (5 percent), Channel Development (9 percent) and All Other Segments (3 percent).[36]

Starbucks operates its own stores and also licenses stores to third-party operators. Licensees pay Starbucks license fees and a portion of all revenues generated by the store in exchange for use of the Starbucks brand name, Starbucks products, detailed store operating procedures, and Starbucks training classes that are similar to those provided to employees of company-owned stores. While Starbucks receives a lower portion of revenues from licensed stores, most operating costs are borne by the licensee, resulting in higher operating profit margins to Starbucks than are earned by company-operated stores. In addition to the license fees and royalties, Starbucks also gains additional market access and retail space as well as local market data and expertise from licensees. In 2016, 79 percent of total net revenues were generated by company-operated stores and 10 percent were generated from licensed stores; see **Exhibit 3** for key financial data over time.[37]

Coffee Industry

Coffee cultivation began in the Arabian Peninsula, which is still known for producing some of the best coffee in the world. Coffee spread to Europe and other parts of the world, and later to the United States.[38] Today, most of the world's coffee is produced in Brazil, followed by Vietnam, Colombia, Indonesia, Ethiopia, and India.[39]

Coffee beans are generally categorized by the varietal of the coffee tree (Robusta or Arabica) and the roast and grind status of the bean (green/unroasted, roasted whole beans, roasted ground beans, or instant/soluble). Arabica is considered to produce a better-tasting coffee and commands higher market prices, while Robusta is able to grow in harsher climates but produces a more bitter-tasting coffee. Three to four years after planting, a coffee tree will produce cherries that contain the coffee bean (which would more properly be called a seed). The coffee cherries are typically harvested once per year, depending on the country where the coffee is produced.[40] To prevent the fresh cherry from spoiling and ruining the coffee bean, the cherries are then processed to remove the pulp, fermented to remove certain elements of the skin, rinsed, dried and stored until export. Before the beans are exported, they are milled to remove the bean's protective hull and inspected to remove any beans that do not meet certain size, weight, or color requirements. After import, the green coffee beans are roasted, at which point they are ready to be ground and brewed into a cup of coffee.[41]

The majority of coffee grown for export is consumed by approximately 35 countries in the Northern Hemisphere which do not have the appropriate climate or market conditions for growing coffee locally; i.e., the United States, Europe, Russia, the Middle East, and Japan.[42] The United States is both the largest and fastest growing market for coffee in the world, consuming nearly 16 percent of the world's coffee supply in 2015 and with its consumption growing at 2 percent per year, compared to global growth of 1.3 percent per year.[43] Some 83 percent of American adults drink coffee, making it a $30 billion industry.[44]

Coffee is grown for export in over 70 developing-economy countries around the world and, for many of them, is a crucial source of national income. In early 2014, Brazil was struck by its worst drought in 50 years, causing 30 percent of its coffee crop to be lost.[45] As Brazil produces almost a third of the world's coffee,[46] this drop in supply caused coffee prices to double.[47] While Starbucks and other large corporations secure future contracts to hedge against short-term coffee price volatility, smaller coffee stores are more likely to be adversely affected by such changes and pass on price increases to their customers.

Farmers and farm laborers occupy the bottom tier of the coffee industry. Growers typically sell green unroasted beans at the commodity market price: $1.49 per pound in October 2016.[48] The average retail price of a pound of roasted and ground coffee in the United States, meanwhile, is $4.37.[49]

The average price per pound of specialty coffee is around $12 and the price per pound of single-serve Kuerig K-Cup coffee pods totals over $50.[50]

Small farmers produce nearly 70 percent of all coffee grown in the world.[51] Although they perform critical tasks in the coffee production process, they also face some of the industry's most potent threats, including high labor production, unpredictable farm productivity depending on weather conditions, which could worsen with climate change.

Currency exchange rates and sovereign monetary policy also affect the farmers' profitability because coffee is an internationally traded commodity. For example, the Vietnamese *dong* is pegged to the U.S. dollar while the Brazilian *real* is not. In early 2016, when Robusta prices were trading 27 percent below their prior year's prices, many Vietnamese farmers opted to stockpile their green coffee beans in hopes of selling the beans at a higher price in the future.[52] Some Vietnamese farmers also chose to convert their coffee farms to other crops, which may alter the coffee industry's supply dynamics for years to come.

In accordance with its social responsibility and sustainability goals, Starbucks established Coffee and Farmer Equity (C.A.F.E.) practices, which "help farmers grow coffee in a way that's better for both people and the planet."[53] Starbucks began selling Fair Trade certified coffee in 2000 and has consistently increased its purchase of fair trade certified coffee. Starbucks has also established Farmer Support Centers in Africa and the Caribbean to provide local farmers with the resources and expertise in several aspects related to coffee production, including environmentally responsible growing methods.[54] As a result of its efforts, Starbucks is recognized for its ethical sourcing; in 2009 and 2010, Starbucks was voted the "Most Ethical Company" in the European coffee industry.[55] It has also been on Ethisphere Institute's list of the world's most ethical companies every year since the list's inception in 2007.[56] In 2016, *Fortune* magazine ranked Starbucks number six on its prestigious ranking of "The World's Most Admired Companies," just behind Apple, Alphabet (the parent company of Google), Amazon, Berkshire Hathaway, and Walt Disney, but ahead of Southwest Airlines, FedEx, Nike, and General Electric, rounding out the top ten.

In addition to its promotion of environmentally friendly coffee production, Starbucks has also focused on Leadership in Energy and Environmental Design (LEED) certification as a tool for making its operations more sustainable. Starbucks opened its first LEED-certified stores in 2005 and now has over 1,000 LEED-certified stores in 20 countries.[57] Additional sustainability efforts include water conservation, energy conservation through the use of efficient LED light fixtures, renewable energy, recycling, use of more environment friendly materials, reducing transportation costs by locally sourcing materials, and reducing waste.[58]

Competition

Starbucks' primary competitors are other specialty coffee shops, such as Dunkin' Donuts, Caribou Coffee, and Peet's Coffee and Tea. But as Starbucks expanded its food offerings throughout the 1990s and 2000s, it began competing with a slew of quick service restaurants like McDonald's and Panera. Many of these restaurants responded by expanding and improving their coffee menus in order to compete against Starbucks' core product offering.

By expanding into the food-service industry, Starbucks also faces new external threats such as increasing consumer concerns regarding adverse health effects associated with fast food and sugary beverages. Starbucks's expansion of its packaged coffee, food, and ready-to-drink products also grew Starbucks's competitive set to include multinational consumer package good companies, such as Coca-Cola and Nestlé.

Dunkin' Donuts

Dunkin' Donuts sells coffee and baked goods, and ice cream under the Baskin-Robbins brand.[59] Dunkin' operates in 60 countries around the world and has over 19,000 points of distribution; 86 of which are either traditional restaurant or convenience store formats, with the remaining 14 percent of distribution points being full- or self-service kiosks in locations such as airports and hospitals.[60] Dunkin' licenses nearly 100 percent of its stores, owning and operating very few restaurants under the corporate umbrella. This allows Dunkin' to focus on innovation and marketing and spend little time and effort on the management of everyday operations. The franchise model also allows Dunkin' to quickly expand its number of stores without requiring large capital expense. Dunkin' Donuts and Baskin-Robbins were both founded in the 1940s and were eventually acquired by the same holding company in the 1980s. Dunkin' Donuts' long history has built substantial brand equity and a significant operational footprint, particularly in the Northeast United States where Dunkin' was founded.[61]

In 2004, Dunkin' began selling premium espresso-based drinks in addition to its traditional American-style brewed coffee. With a similar coffee menu offered at lower prices, Dunkin' began successfully competing directly against Starbucks; espresso drinks comprised nearly 10 percent of Dunkin's sales in 2004.[62] In 2015, coffee sales generated 58 percent of Dunkin's franchise-reported sales.[63]

Dunkin' has continued to respond to Starbucks' product expansion. In September 2016, Dunkin' Donuts announced that it would begin selling bottled coffee in U.S. retailers beginning in 2017 through a partnership with Coca-Cola.[64] The terms of the deal allow Coca-Cola to bottle and distribute bottled Dunkin' Donuts coffee through its existing retailer relationships. This development directly challenges Starbucks' lucrative Frappuccino brand that are sold through a joint venture with PepsiCo. As of June 2016, Starbucks commanded a 75 percent market share of the U.S. ready-to-drink coffee market that was valued at $2.5 billion in 2015, following four consecutive years of 10–14 percent growth.[65]

However, Dunkin' Donuts has not expanded internationally as aggressively as Starbucks. In 2015, the Dunkin' Donuts operating segment reported revenues of $614 million, with $591 million of sales in the United States and only $23 million sold abroad. Dunkin' Donuts' U.S. corporate revenue was generated from $7.2 billion of franchise-reported sales, representing a 6.8 percent compound annual growth rate in sales over the previous 10 years. However, the number of U.S. distribution points has grown at a lower rate of 5.78 percent from 4,815 to 8,431, suggesting that Dunkin' has been able to effectively grow same-store sales over the same period.[66]

Caribou Coffee, Peet's Coffee and Tea, and JAB Holding

Caribou Coffee is a specialty coffee retailer and competes directly with Starbucks' core offering. Caribou started in 1992[67] targeting office workers. As of May 2015, Caribou directly operated 273 stores in the United States and licensed operations to an additional 127 domestic stores across 18 states, and 203 international stores in ten countries abroad.[68] Although much smaller than Starbucks, Caribou Coffee pursues a similar market strategy as Starbucks, emphasizing high quality espresso drinks, customer experience in a "third place," and its sustainable business practices.

Peet's Coffee & Tea was founded in 1966 in California[69] by Alfred Peet, who introduced custom coffee roasting in the U.S. and inspired several specialty coffee makers, including the founders of Starbucks. Peet's has traditionally focused on the sale of its fresh whole bean coffee, but has increasingly focused on freshly brewed coffee and coffee-based beverages, with its net income doubling from 2007 to 2011.[70] Peet's currently operates 245 stores in 10 U.S. states, pursuing similar business strategies as Starbucks and Caribou Coffee.[71]

In 2014, Peet's acquired the premium tea brand Mighty Leaf Tea. In 2015, Peet's acquired the premium craft coffee companies Stumptown Coffee Roasters and Intelligentsia Coffee–all for undisclosed amounts.[72] Stumptown and Intelligentsia were both leaders in the so-called "third-wave" or "craft" coffee movement, which focuses on providing the highest possible quality of coffee to the customer, even if it is more expensive or requires a longer wait than a comparable Starbucks serving.[73]

In 2012, JAB Holding, a privately held German investment company, acquired both Caribou Coffee and Peet's Coffee and Tea, for $340 million and $974 million, respectively.[74] In addition to Caribou and Peet's, JAB also owns majority interests in a wide range of Starbucks competitors, including Einstein Noah Restaurant Group (acquired for $374 million in 2014),[75] Kuerig Green Mountain ($13.9 billion in 2015),[76] and Krispy Kreme ($1.35 billion in 2016)[77] in the United States; Espresso House, Scandinavia's largest coffee store chain ($118 million in 2015);[78] and Jacobs Douwe Egberts, the producer of 38 international coffee and tea brands ($4.2 billion in 2015).[79] This portfolio of coffee and consumer packaged goods companies collectively represents a formidable challenge to Starbucks.

Other Competitors

McDonald's began selling hamburgers in 1948, with a simplified menu that enabled the company to quickly provide food to the customer. Ray Croc joined McDonald's in 1955 and helped grow the company into a leader in the global restaurant industry. McDonald's opened its first international restaurant in 1967, two decades before Schultz bought out Starbucks' founders.[80] As of 2016, there were more than 36,000 McDonald's stores operating in some 120 countries around the world.[81] Unlike Starbucks, the majority of McDonald's restaurants are franchised; only 20 percent of the stores are company operated, and McDonald's has the goal of operating as few as five percent of all stores.[82]

In recent years, McDonald's has been experiencing inferior performance.[83] This is partly because (younger) consumers prefer brands that offer fresher and healthier food options, and McDonald's has been slow to respond. From 2013 to 2015, McDonald's experienced three consecutive years of declining revenue, operating income, net income, and diluted earnings per share; from $28.1 to $25.4 billion, $8.8 to $9.8 billion, $5.6 billion to $4.5 billion, and $5.55 to $4.80, respectively.[84]

As a result of the declining performance, McDonald's named Steve Easterbrook as the new CEO in March 2015. By May 2015, Easterbrook announced a restructuring and turnaround plan.[85] McDonald's new reporting structure segments its stores by geography and stage of market development, with the U.S. as its main market; then international lead markets (e.g., Australia, Canada, and France); high growth markets (e.g., China, Korea, and Russia); and foundational markets and corporate (remaining markets and other corporate activities). This new structure was designed to reduce corporate bureaucracy and increase McDonald's ability to more quickly implement strategic initiatives. In 2015, the U.S., international lead markets, and high growth markets comprised 34 percent, 30 percent, and 24 percent of revenue, respectively.[86]

In October 2015, McDonald's rolled-out an all-day breakfast menu in its U.S. stores. The all-day breakfast was the largest initiative since the introduction of the McCafé espresso-based drink menu in 2009.[87] These expansions of McDonald's menu successfully compete against Starbucks's core menu. Not only offering McCafé at a steep discount in comparison to Starbucks' premium prices, as early as February 2007, a Consumer Reports blind taste-test showed that McDonald's served a better cup of coffee than Starbucks.[88]

Panera Bread, founded in 1981,[89] is a bakery-café chain operating exclusively in the U.S. and Ontario, Canada. Its primary offerings are fresh, healthy, organic baked goods served at a "warm, inviting, and comfortable environment."[90]

Several recent Panera initiatives compete with Starbucks' core strategies. In 2014, for example, Panera unveiled Panera 2.0, a series of technologies to enhance customer experience.[91] In June 2016, Panera committed to removing all artificial sweeteners, flavors, and preservatives from its menu by the end of the calendar year.

From 2013 to 2015, the number of Panera stores had 5.4 percent compound annual growth, from 1,777 stores in 2014 to 1,972 in 2016. In 2015, Panera owned 901 stores and the remaining stores were owned by franchisees. Panera's financial performance over the same period has been more mixed; although revenue grew from $2.1 billion in 2013 to $2.4 billion in 2015, operating profit and net income both declined, from $309 million to $242 million and $196 million to $149 million, respectively.[92]

Keurig Green Mountain, Nestlé's Nespresso brand, and other coffee machine manufacturers are also indirect competitors with Starbucks, as they encourage customers to brew their own coffee. Starbucks has pursued cooperative strategies with these companies by, for example, offering single-serve coffee pods for Keurig's brewing machines.[93]

Current Challenges

In 2014, CEO Schultz announced the goal of growing Starbucks' annual revenue to $30 billion and global store count to 30,000 stores around the world within the next five years.[94] While watching the sun set over Elliott Bay, his mind lingered on three persistent challenges that needed to be addressed to make his stretch goals become reality: Starbucks' dependence on an increasingly saturated U.S.

market, Starbucks' stronger focus on competitive international markets to meet its growth targets, and how to best grow the Starbucks digital engagement without sacrificing customer experience.

SATURATION OF U.S. MARKET

From 2015 to 2016, Starbucks opened an additional net 804 stores in the Americas, increasing the total number of stores from 14,803 to 15,607.[95] Starbucks' quarterly earnings throughout 2016 showed the potential problem of such a reliance on a single market. In the third quarter of 2016, comparable-store sales grew by only four percent in the Americas, whereas comparable-store sales growth "had been at or above five percent for the 25 consecutive quarters prior to Q3 [2016]," according to Schultz. The limited growth in comparable-store sales growth suggests to some analysts that Starbucks was nearing saturation of its largest market. Would Starbucks' efforts to diversify its menu be enough to alleviate these fears?

GLOBAL GROWTH

Schultz believed that Starbucks' largest growth opportunities might lay outside the United States. In China alone, Starbucks is planning to operate 5,000 stores by 2021, more than double the 2,400 stores in 2016. Outside China and Japan, Starbucks also plans to double its number of cafés elsewhere in Asia to more than 4,000 in the next few years. Will Starbucks be able to recreate the magic of the "third place" in countries around the world?

DIGITAL STRATEGY

Starbucks also faces the challenge of improving and enhancing digital customer engagement. Starbucks successfully rolled out several technology products that increased customer loyalty through a streamlined purchase process and enhanced in-store experience. Starbucks "value cards" gave customers a convenient payment method and allowed customers to give the cards as gifts. Customers that registered their card in the US, Canada, and certain other countries were automatically enrolled in the My Starbucks Rewards® program that offers benefits based on the number of reward points earned and other factors. There are over eight million active members in the rewards program.

Starbucks also partnered with Google to offer faster in-store Wi-Fi, and subsequently partnered with several other service providers, such as the music-streaming service Spotify and the ride-sharing service Lyft. Starbucks' Digital Network provides easy access to news and local information from one browser when connected to the store.

Starbucks also launched a comprehensive app for iPhone and Android. Customers can order and pay, earn rewards, find stores – all from one app on their phone. The app's "Mobile Order and Pay" feature comprised six percent of all US transactions in the fourth quarter of 2016, increasing operating efficiency, especially during peak demand hours.[96]

However, these digital platforms also brought challenges. In 2014–15, for instance, hackers used the Starbucks app to access customer bank accounts.[97] And could Starbucks continue to drive customer loyalty through the app, even if it reduced interaction with the barista or time spent in the store?

Kevin Johnson, Starbucks' New CEO

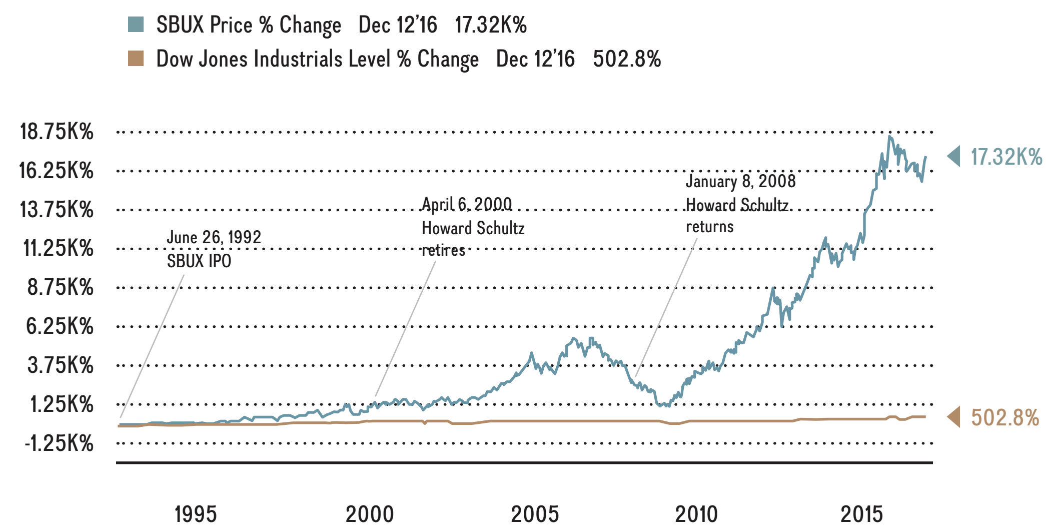
But Howard Schultz realized that he no longer had to worry about these immediate strategic challenges because his lieutenant, COO Kevin Johnson, took over as CEO in April 2017. Johnson joined the Starbucks management team in 2015, and as COO, was responsible for Starbucks' entire business operations across the globe, as well as all the core support functions of supply chain, marketing, human resources, technology, and mobile and digital engagement. Prior to Starbucks, Kevin Johnson worked in the technology industry, thereof 16 years for Microsoft and a five-year stint as CEO for Juniper Networks.

Howard Schultz, Retirement Episode 2

Schultz looked forward to his second attempt at retirement. Stepping down as CEO would free him from the day-to-day management, and allow time to dedicate himself more fully to coming up with a more refined concept and rolling out his new Starbucks Reserve Roastery. The idea is to move to high end coffee brewed by the most skilled baristas in their craft in order refresh the Starbucks brand as it faces increasing competition from high-end specialty roasters such as Stumptown and Intelligentsia. In particular, Schultz will focus on building a chain of high-end coffee shops that will charge as much as $12 a cup in an exclusive setting. After opening its first super-premium café and roasteries in Seattle in April 2016, Starbucks plans to open three additional roasteries in 2018, in New York City, Shanghai, and Tokyo.

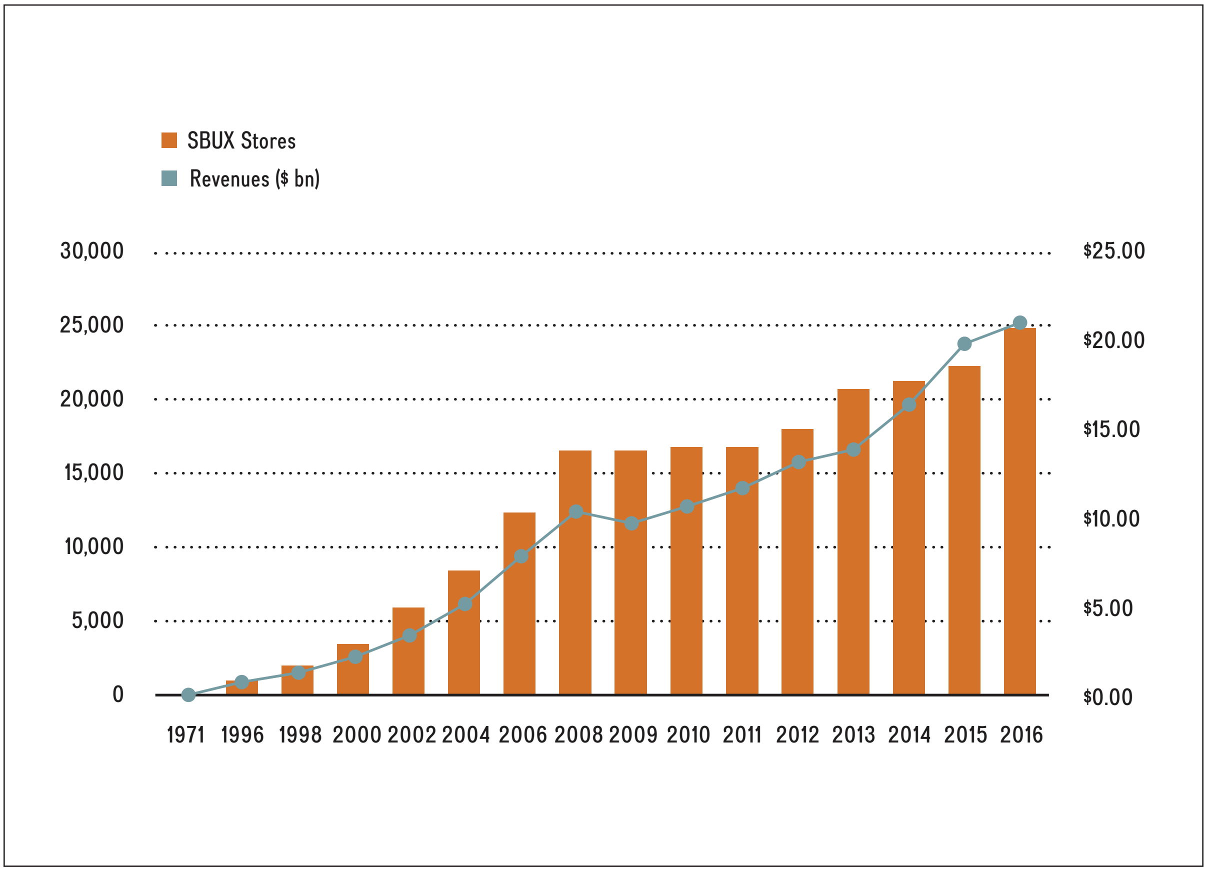
Many wonder if his gut feeling about moving to the super high-end coffee experience is as correct as his first hunch some 30 years earlier when he also relied on his instinct to roll out the initial Starbucks concept nationwide in the U.S., and subsequently internationally with astonishing success.

EXHIBIT 1 Starbucks (SBUX) Normalized (% Change) Stock Appreciation from Initial Public Offering (IPO) on June 26, 1992 to December 12, 2016. Comparison is Dow Jones Industrials.



Source: Depiction of publicly available data.

EXHIBIT 2 Starbucks Number of Stores (left axis) and Revenues (in billion $, right axis), 1971-2016



Source: Depiction of publicly available data.

EXHIBIT 3 Starbucks Financial Data (in $ millions, except earnings per share (EPS) data), 2012–2016

Fiscal Year	2012	2013	2014	2015	2016
Cash and short-term investments	2,037.0	3,233.8	1,843.8	1,611.4	2,263.2
Receivables (total)	485.9	561.4	631.0	719.0	768.8
Inventories (total)	1,241.5	1,111.2	1,090.9	1,306.4	1,378.5
Property, plant, and equipment-total (net)	2,658.9	3,200.5	3,519.0	4,088.3	4,533.8
Depreciation, depletion, and amortization (accumulated)	4,244.2	4,581.6	5,062.1	5,553.5	6,039.5
Assets (total)	8,219.2	11,516.7	10,752.9	12,446.1	14,329.5
Accounts payable (trade)	398.1	491.7	533.7	684.2	730.6
Long-term debt	549.6	1,299.4	2,048.3	2,347.5	3,202.2
Liabilities (total)	3,104.7	7,034.4	5,479.2	6,626.3	8,438.8
Stockholders' equity (total)	5,109.0	4,480.2	5,272.0	5,818.0	5,890.7
Sales (net)	13,299.5	14,892.2	16,447.8	19,162.7	21,315.9
Cost of goods sold	10,161.3	11,125.6	11,954.3	13,721.0	15,120.8
Selling, general, and administrative exp.	801.2	937.9	986.3	1,184.8	1,360.6
Income taxes	674.4	(238.7)	1,092.0	1,143.7	1,379.7
Income before extraordinary items	1,383.8	8.3	2,068.1	2,757.4	2,817.7
Net income (loss)	1,383.8	8.3	2,068.1	2,757.4	2,817.7
Earnings per share (basic) excluding extraordinary items	1.83	0.01	2.75	1.84	1.91
Earnings per share (diluted) excluding extraordinary items	1.79	0.01	2.71	1.82	1.90

Source: Starbucks Annual Reports (various years)

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