HARVARD | BUSINESS | SCHOOL

9-714-409
REV: JULY 7, 2014

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Coffee Wars in India: Café Coffee Day Takes On the Global Brands

V.G. Siddhartha, founder and chairman of Amalgamated Bean Coffee (ABC) Trading Company, popularly known as Café Coffee Day, sipped a frothy cappuccino in his office in the South Indian city of Bangalore. ABC was a privately held company, with minority investments by several private equity firms, such as KKR. The crown jewel in ABC was Siddhartha's retail creation, Café Coffee Day (CCD), which successfully developed the café culture in India. Although India was historically a tea-drinking nation, where a cup of *chai*[a] could be purchased at a roadside stall for a few rupees, CCD attracted India's large young population with espresso-based beverages, snacks, jukeboxes, and popular merchandise. The company also operated takeout kiosks in heavily populated areas; sold fresh ground coffee through retail outlets in southern India; and had premium café formats for older customers. By April 2013, CCD was India's leading coffee chain, with over 60% of the market. India's *Economic Times* had named CCD as one of India's most trusted brands—ranked No. 2 in the Food & Beverage segment.[1] The company's bright-red logo, along with its popular tag line, "A lot can happen over coffee," was a familiar sight across urban India.

Seven months earlier, U.S.-based Starbucks Coffee Company (Starbucks) had opened its first 11 stores in Mumbai and Delhi, India's commercial and political capitals. Starbucks was the world's largest coffee chain company, with over 18,000 outlets across 62 countries. Starbucks had entered India through a joint venture with the Tata Group, India's largest business conglomerate, giving it access to coffee plantations as well as premium real estate. Despite its high prices, Starbucks received a grand welcome, including massive media coverage and long queues outside its luxurious stores.

Siddhartha and the director of CCD, Venu Madhav, had plenty of experience beating global brands in India. Costa from the U.K., Lavazza from Italy, Gloria Jean's from Australia, and Coffee Bean & Tea Leaf from Southern California in the U.S. had all struggled to make significant inroads in the Indian market. Yet Siddhartha and Madhav wondered if Starbucks might be different. In their discussions, Madhav and Siddhartha were reasonably confident that CCD "only needed a slight course correction" to handle Starbucks, but they also debated whether a bigger, bolder response was necessary.

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[a] *Chai* is a Hindi word for tea prepared with milk, sugar, and sometimes spices.

Professor David B. Yoffie and Research Associate Tanya Bijlani prepared this case. It was reviewed and approved before publication by a company designate. Funding for the development of this case was provided by Harvard Business School, and not by the company. Professor Yoffie had a prior business relationship with the current chairman of CCD. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

India's Coffee Market

Coffee vs. Tea

Tea had been consumed for generations in India, with Indians consuming almost 10 times more tea than coffee in 2011.[2] However, people in the South Indian states of Tamil Nadu, Karnataka, Andhra Pradesh, and Kerala brewed and drank "filter coffee," a sweet milky coffee made from roasted coffee beans and sometimes chicory.[b] In recent years, coffee had become increasingly popular among Indian students, young adults, and professionals across the country. Coffee consumption had grown at a compound annual growth rate (CAGR) of 6.8% between 2001 and 2011, compared to only 3.6% for tea.[3] (See **Exhibit 1** for details on India's coffee market.) With Indians consuming only around 100 grams of coffee per person, compared with 4.5 kilograms in the United States, experts felt that there was plenty of room for market growth.[4]

Retail Coffee

Coffee was sold primarily in small mom-and-pop grocers across India, also known as *kirana* stores. Supermarkets and hypermarkets[c] were also growing in India, capturing 20% of coffee sales volume by 2011.[5] The two dominant retail fast-moving consumer goods (FMCG) coffee brands in India were Bru from Hindustan Unilever, the Indian arm of Unilever, and Nescafé from Nestlé India. Exclusive coffee retail chains like CCD's Fresh and Ground and Bangalore-based Bayars Coffee were also increasing in popularity.

Specialist Coffee Chains

The coffee revolution in India began in 1996 when CCD set up its first coffee shop under the brand name Café Coffee Day. Four years later, the local start-up, Barista Coffee Company (Barista), set up operations in the country, which were later taken over by Lavazza, Italy's largest coffee company. U.K.-based Costa Coffee opened shops in India's large cities in 2005, followed by U.S.-based Coffee Bean & Tea Leaf and Australia's Gloria Jean's in 2008. Other recent entrants in the market included Dunkin' Donuts, which sold more cups of coffee than any other foodservice[d] chain in the United States, followed by Starbucks in 2012. By 2011, there were 2,300 specialist coffee shops across India, 95% of which belonged to chains.[6] The foodservice volume of fresh coffee had grown by over 40% since 2005.[7] Similar to the trend in other countries, cafés in India were becoming popular outlets for socializing.[8] One report elaborated:

> In a country where there is a limited bar culture, and where drinking alcohol is still frowned upon in many circles, it [the coffee shop] has provided an acceptable and safe outlet for people, particularly young Indians, to share a drink. It is common to see large groups of teenagers congregating at coffee shops late into the evening. Some branches provide guitars for jam sessions. It has also helped facilitate the country's growing dating culture—having a girlfriend or boyfriend at a young age is frowned upon by many, so secret trysts at a coffee shop have become the norm for many young Indians, and serve as a suitable bolt-hole away from the prying eyes of parents.[9]

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[b] Chicory is a caffeine-free herb that is popularly used as a coffee substitute.

[c] A hypermarket is a combination of a department store and a supermarket for groceries.

[d] Foodservice refers to the practice or business of making, transporting, and serving or dispensing prepared foods, as in a restaurant.

Some Indian coffee chains earned as much as 35% of their revenues from food, compared with only 15% for coffee chains in the United States. "Here, customers often come to the store with their families and have a full meal," explained Sushant Dash, senior director of marketing at Tata Starbucks, the joint venture between Starbucks and the Tata Group in India.[10] As a result, Indian coffee chains were customizing their menus to suit regional tastes, offering local specialties like *idli*[e] in South India and *vada pao*[f] in West India, and strictly vegetarian cafés in religious and pilgrim centers;[11] they were also expanding their menus to include ice creams and desserts.

In April 2013, CCD was India's leading coffee chain, with 1,469 stores, 1,000 takeout outlets, and over 60% of the market, followed by Barista, with over 175 stores, and Costa Coffee, with over 100 stores. Both established and new players were planning rapid expansion, and India's organized café market was expected to increase from $230 million in 2012 to $410 million in 2017.[12] CCD planned to open 400 stores over the following 30 months; Dunkin' Donuts, 100 stores over five years; and Costa Coffee, 100 stores in two years.[13] (See **Exhibit 2** for details on the coffee chains.) Industry observers speculated that Starbucks might open 300 stores in three years.

The Coffee Day Company

History

Siddhartha came from a family that owned 350 acres of coffee plantations in the hilly Chikamagalur district of Karnataka, also known as "coffee land." At the age of 21, he decided to start out on his own and moved to Mumbai, where he worked as a management trainee for Mahendra Kampani, co-founder of JM Financial Services, an Indian advisory and brokerage firm. "I would tell all the office boys to pack up, and it was I who took Mahendra Bhai's dabba [lunch box] to load it in his car as the last item of work. In the process, he taught me all about the world of investing. He trusted me. He let me handle the accounts of some really big business houses."[14]

In 1985, Siddhartha started a business in equity trading. In 1993, he began to concentrate on the coffee market by investing the profits from the equity business to acquire plantations and curing[g] units in India. At the time, Indian coffee farmers were obligated to sell their produce to the Coffee Board, a government body that auctioned all the coffee produced in the country at periodic intervals and paid the farmers a meager amount, keeping most of the profit for itself. Siddhartha recalled:

> In the 1980s, the Coffee Board had 4,000 people to trade 100,000 tons of coffee, and the system was inefficient and bureaucratic. All a farmer would get was $0.35, even though the international price was $1.20. In 1993, we sponsored the Growers Federation to meet Manmohan Singh, then India's finance minister. We told him about the situation, and he began the process of deregulating the coffee market, and coffee farmers became free to sell their crop to anyone they wanted.

By then Siddhartha owned over 3,000 acres of coffee plantation and started Amalgamated Bean Coffee Trading Company Limited (ABC). By 1995, ABC had become India's largest coffee exporter. Siddhartha said, "I thought to myself that if I can do this in two-and-a-half years, the international

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[e] Savory rice and lentil cakes.

[f] Fried potato snack served with bread.

[g] Coffee curing is the process of removing the husk and parchment cover of raw coffee beans and converting them into clean, green coffee beans.

traders can throw me out in a year. I have to brand this product, and if I don't, I will be out of business."

In 1994, Siddhartha and his team opened approximately 20 stores in each of the South Indian cities of Bangalore and Chennai under the brand name Coffee Day Fresh and Ground, which sold high-quality coffee beans and freshly ground coffee for customers to brew at home. The business proved successful, prompting Siddhartha to move yet another step up the coffee value chain and enter the café business. He elaborated:

> In 1995, I wanted to put up a café on Brigade Road, a busy and fashionable street in Bangalore. My colleague asked me why anyone in their right mind would buy coffee from me for Rs. 25 [Indian rupees] when, down the street, a shop was selling it for Rs. 5. A few months later in Singapore, I came across a pub where youngsters were surfing the Internet and drinking beer. The Internet was just taking off in India, which inspired me to set up a café where customers could surf the Web. We set up our first café with the first 64-kbps dedicated line in India, 17-inch IBM computers, air conditioning, and high-end furnishings that had not been seen anywhere in the country. For Rs. 100, a customer could surf the Net for an hour, along with a cappuccino. It was a big success.

By late 2000, however, as people began accessing the Internet increasingly from home, the company dropped its Internet offering and embarked on its path to become the dominant coffee café in India.

The Market Leader

By April 2013, CCD was the clear market leader in India, with 1,469 cafés (including what were called "Lounges" and "Squares"), 1,000 Xpress kiosks, 450 Fresh and Ground retail outlets, and 22,000 vending machines in over 200 Indian towns; it was also one of the largest exporters of coffee in the country. Half of CCD's outlets were in busy high-street locations; a large proportion of its stores were in malls and corporate campuses. CCD had also expanded internationally, with 18 outlets in Vienna, Prague, and Pakistan. Siddhartha's ambitions were clear: "I want CCD to be the number-two or number-three retail coffee brand in the world in the next 20 years!" In March 2013, the company had revenues of more than US$200 million and was profitable.

In the short run, CCD aimed to have 2,000 cafés and 1,500 Xpress outlets in 500 Indian towns by the end of 2015. The company also planned to launch instant coffee for sale at its cafés in 2014 and, over time, planned to offer a bouquet of products in grocery stores and supermarkets across India, including instant coffee, cold drinks, bottled water, and capsule machines. Siddhartha was bullish on the market in general and CCD in particular:

> We think that India will have 5,000 cafés in the next five to six years, and we want to have a majority of that market. There is also a mind-boggling opportunity to launch new, related products through other channels. Ultimately, we can become a 50-50, foodservice to non-foodservice business. Given our cost structure, we can be a player not only in India, but internationally as well.

Targeting India's Youth

To deliver on this vision, CCD focused on full-fledged cafés targeting young people between the ages of 15 and 30 from India's middle and upper-middle classes, positioning itself as "a place between home and work, to hang out with friends."

CCD's cafés were typically 800 to 1,000 square feet in area, with a storefront that displayed the company's bright-red logo, later fashioned into a callout box that symbolized conversation, along with the tag line, "A lot can happen over coffee." (See **Exhibit 3** for photos of a café.) In addition to classic coffees, they offered a range of cold coffees and iced drinks that were popular with teenagers and young customers, and food items that included ready-to-eat sandwiches and burgers, Indianized snacks like *samosas*[h] and chicken *tikka*[i] sandwiches, as well as desserts like brownies, pastries, and ice creams. CCD's cafés often had jukeboxes and sold merchandise like T-shirts, bags, pens, and coffee filters.

CCD located its outlets in urban areas with large young populations, such as high streets, malls, educational institutions, and campuses of IT and business process outsourcing firms, and opened outlets in multiple cities simultaneously. Madhav explained, "Our strategy was to seed the café culture rapidly in different cities, and accelerate the establishment of the brand."

CCD ensured that its cafés were reasonably priced. Ramakrishnan, CCD's president of marketing, explained, "There is a big gap in pricing between us and most of our competitors. We are attracting youth, including college students, so our cafés have to be an affordable luxury to our customers. Sometimes, there is a temptation to increase prices closer to others, but we have resisted. Even if we are leaving money on the table, in the long run, affordable pricing means that we will have more customers." (See **Exhibit 4** for the economics of a café.)

Historically, CCD stayed away from mass media advertising and focused instead on targeted promotional activities. For instance, to increase foot traffic, cafés would sell tickets for rock concerts and create contests around popular television shows and youth-oriented brands, with winners receiving merchandise and paid trips. The company also allowed scenes for popular Indian movies, with similar target audiences, to be filmed at its cafés. CCD's executives found that focusing its marketing activities in collaboration with other youth-focused brands drove business to its cafés and helped attract India's large young population. CCD also encouraged its café staff to be "friends" to its customers and communicate with them on a personal level, rather than just cleaning tables and serving them, a shift from traditional Indian culture in which people did not always look upon those serving them as their peers.[15]

In 2004, CCD estimated that approximately 60% of its customers were regulars, visiting its cafés twice a week or more.[16] Harish Bijoor, CEO of Harish Bijoor Consultants and former vice president at Tata Coffee, summarized, "Coffee Day has mastered the core competency of opening outlets, building a strong brand, and making a strong emotional connection with its target group." Barista, its closest competitor, on the other hand, "tried to be everything to everyone and ended up being nothing to anyone," he added.[17]

Building Operational Efficiency

CCD had a vertically integrated business model. The company sourced coffee from its own 11,000 acres of plantations, employing around 3,000 plantation workers and managing another 3,000 acres owned by other growers. It also operated two curing mills with a total capacity of 70,000 tons, the largest in India, and a roasting and blending facility. Ramakrishnan explained:

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[h] *Samosas* are a fried pastry stuffed with potatoes, green peas, and spices.

[i] *Tikka* refers to a style of cooking in which food is marinated in spices and dry roasted, usually in a clay oven.

> Since we produce our own coffees, it becomes very easy for us to take the best coffee and store it for ourselves, rather than buying it from the market. Consumers also see us as coffee experts. Telling potential store employees that we were a coffee-growing company getting into the café business also helped attract the right talent in the early days.

CCD also manufactured its own coffee-vending machines and café furniture and procured equipment such as air conditioners, ovens, and pastry coolers nationally. Management estimated that furniture, for example, was 15%–20% of the capital costs for a store, and internally sourced furniture could save over 25% compared to volume wholesale purchases. Similarly, it manufactured coffee machines at a cost of approximately $2,000 compared to $7,000 for an imported machine. Jayaraj Hubli, CCD's chief financial officer, explained, "Right from capital expenses to raw materials, we check round the clock to see where else we can get a better price for the same quality product, or a better-quality product for the same price. Our goal is to source at prices at least 20% lower than our competitors."

CCD owned its cafés, rather than franchising them, to ensure quality control. Moreover, retail locations were critical. Siddhartha noted that CCD spent "a lot of time choosing retail locations. . . . [I]n a month, we analyze 250–300 locations, and select 25 of them."[18] While most companies in the quick-service restaurant business took three-and-a-half months to convert an empty space into a functioning outlet, CCD was able to set up its cafés in 50 days, which included getting the necessary licenses, electricity supplies, and water.

Staffing was equally critical in the café business. CCD hired its café staff directly onto its rolls, rather than contracting them through third parties. The company also ran a residential hospitality college where, at a cost of $900 each, it trained village youth in café operations and taught them functional English in six months. The college supplied approximately 2,000 of CCD's 7,500 café staff in 2013; executives found that their attrition was far less than those who were hired from other sources. As one CCD executive noted: "Ours is the only brand in the world that has a fully backward integrated model, which means that right from the growing of the coffee to serving it, we own the process, from the bean to the cup. We don't franchise and we don't have middlemen anywhere."

Segmenting the Market

As CCD expanded, the company began to introduce new product and service formats that catered to a wider customer base. In 2002, the company launched 60-square-foot counter-style outlets where customers on the move could order takeout drinks and ready-to-eat-snacks, such as puffs and wraps. Branded "Coffee Day Xpress," these outlets were located in highly populated areas such as railway stations, airports, hospitals, and gas stations. By February 2013, the company had approximately 1,000 such outlets across the country.

In 2010, CCD opened its first Coffee Day Lounge, a large café catering to customers aged 28 to 36, in Bangalore. Lounges were 40%–50% larger than cafés and provided an upscale ambience, with more space between tables, softer music, and subdued colors. Unlike cafés, where food items were delivered on a daily basis, each Lounge had a kitchen and a chef, and offered a wider menu that included salads, appetizers, burgers, pastas, pizzas, and so on, bringing it into competition with casual dining chains. Lounges also provided alternative methods of brewing coffee, in which equipment was brought to the table and coffee was extracted in front of the customer. A typical Lounge delivered twice the revenue of a typical café. A CCD executive explained: "Many people in India have probably grown up with Café Coffee Day. They may have had their first date there, or their first job interview there. But they reach a stage in life where they like the brand, but are looking for something more than what the café has to offer. It is with these people in mind that we opened the Lounge." (See **Exhibit 5** for a photo of a CCD Lounge.)

In 2008, CCD launched its first Coffee Day Square in Bangalore. A Square was twice the size of a Lounge, with a more upscale ambiance as well as gourmet foods and coffees from exotic locations such as Ethiopia and Guatemala. "CCD Squares are meant for coffee connoisseurs who appreciate the nuances of single-origin coffee, while Lounges are targeted at trendy, affluent customers who want to explore alternative brewing of coffee," Madhav explained. (See **Exhibit 6** for a photo of a CCD Square.) A Square could generate four to seven times the revenue of a café.

In April 2013, CCD had 46 Lounges across India and two Squares. A cappuccino was Rs. 66 in a café, Rs. 80 in a Lounge, and Rs. 119–167 in a Square. Of course, Lounges and Squares had higher operating costs and required more complex staff recruitment and training. CCD's short-term plans were to open about 200 new outlets in the coming year; roughly 90% would be cafés, 9% Lounges, and 1% Squares. Madhav commented, "In India, cafés will always be the lion's share." (See **Exhibit 7** for a comparison of formats.)

Growth Challenges

The growth of the Indian retail industry meant that CCD, like other coffee chains, found it difficult to find good properties at reasonable prices. Most Indian retailers, whether they sold coffee, clothing, or electronics, had similar space requirements and competed with each other for the same properties. Siddhartha added, "We can't afford to pay very high rentals. If our rent to revenue ratio goes above 20%, it would cause trouble."[19] As a result, the company sometimes entered into agreements with landlords to pay a discounted rent or a percent of a café's revenues, whichever was higher. Hubli explained, "In that case, if our sales are low, they are guaranteed a minimum amount; but if our sales are high, then they earn more."

Given the growing opportunities in Indian retail, CCD faced store-level attrition, as did any other retailer, and attracting and retaining the right talent was a challenge. According to Siddhartha:

> Five or six years ago, opportunities in India were limited, and there was less attrition at the café staff level. But today, retaining, training, and motivating people at those levels is a big challenge. We pay our employees Rs. 8,000–13,000 a month, but some other retailers pay them a lot more. We show our employees the growth path ahead of them by giving them opportunities for rapid promotions.

Siddhartha also pointed out that customer service was a concern:

> People who go to a five-star hotel and those who visit our store expect the same service. We are spread across more than 200 cities, and have over 7,000 people. We are currently investing significantly in improving service levels.

Keeping consumers engaged was another challenge. Madhav explained:

> Unlike the restaurant business, where customers visit every month or two, many of our customers visit us three or four times a week. The café business is a bit like the fashion business, where we have to follow the latest trends. Earlier, we could probably afford to refresh our menus every two or three years, but market forces are changing, and we need to do this every quarter in order to remain relevant.

Finally, keeping the stores busy throughout the day was a challenge. Most Indians consumed their first beverage at home along with breakfast and received another beverage at work for free. They ventured to cafés only in the afternoons, when they were ready for a break. As a result, most cafés in India did very little business until 11:00 a.m., unless they were located in transportation hubs. CCD tried offering breakfast in order to draw more customers into its stores in the mornings, but executives found that, culturally, it wasn't working.

Enter the Competition

While there were always going to be operational challenges scaling the coffee business in India, competition from global brands had not been a huge impediment until 2013. The market was growing quickly, and CCD had emerged as the clear leader because of its differentiated and focused strategy. But the entry of Starbucks raised new challenges. While CCD was the dominant player in India, Starbucks was the dominant player in the world. For CCD to accomplish its global ambitions, competing effectively with Starbucks in India would represent its first real test.

Starbucks Coffee Company

In 1987, Schultz bought Starbucks for $3.8 million, including its six retail stores and coffee-roasting facility. He immediately began to open cafés under the Starbucks brand in cities such as Seattle, Portland, and Vancouver, where a strong coffee culture existed. "Our strategy was to gain a foothold in each market and create a strong presence there before we moved to another city," Schultz explained.[20]

Starbucks' initial philosophy was to become the "third place," where customers could go to relax, meet friends, and enjoy a special cup of coffee outside their homes or work. As Starbucks expanded into new cities like San Francisco and Chicago and regions in the Midwest, it opened stores in high-visibility locations with high foot traffic near workplaces, shopping areas, and movie theaters; it also opened takeout kiosks in heavily congested areas. It often opened several stores in close proximity to one another, which its executives felt helped build customer loyalty, deterred competitors from entering, and sometimes cannibalized its own business. In the late 1990s, the company began opening cafés within large bookstore and department store chains like Barnes & Noble and Nordstrom.

Starbucks did not advertise. Instead, it relied on superior customer service and word-of-mouth to attract customers. It encouraged its café staff to greet regulars by their first names and remember their favorite drinks, and it instituted a "just say yes" policy to any complaint, so staff could replace drinks or offer free drink certificates. The company also set high standards for its store ambience and provided convenient venues for meetings, phone calls, and work. By the mid-1990s, Starbucks had a loyal customer base that included professionals, students, taxi drivers, artists, and shoppers. By the end of 1996, Starbucks was the most widely recognized brand of specialty coffee in the United States.[21]

Starbucks took several measures to ensure the quality of its operations and offerings. The company purchased its coffee beans directly from producing countries, unlike some of its competitors that relied on wholesalers. Similar to CCD, Starbucks owned most of its stores, rather than franchising them. The company also invested heavily in talent, including its café staff employees, whom it referred to as "partners." In 1988, it began offering health coverage to all café staff who worked 20 or more hours a week and later instituted a stock option plan for employees. By the mid-1990s, the company had approximately 60% annual attrition among staff, compared with 140% to 300% for the fast-food industry.[22]

As its café business grew, Starbucks also entered the supermarket channel. In 1995, the company began selling Starbucks-branded coffee-flavored ice cream in supermarkets across the U.S., in partnership with Dreyer's Grand Ice Cream Company. In 1997, it started to sell a bottled version of its Frappuccino cold coffee in supermarkets, in partnership with PepsiCo. In late 1999, the company began to sell its ground coffee and beans in 8,500 supermarkets across the United States through an agreement with U.S. food conglomerate Kraft.[23] In 2009, Starbucks launched Via, an instant coffee powder, that it distributed in its stores and later through retailers like Target and Walmart.

Global Expansion

In 1996, Starbucks opened its first international stores in Japan, followed a few years later in China, the U.K., and Switzerland, and other European and Asian markets where the coffee-drinking culture was less entrenched. Later it moved to mature coffee-drinking markets like France, Italy, and Latin America. Schultz explained:

> The decision was made to go to Asia first because we felt that the maturity of the coffee market in Europe was very strong, and was not going to change much over the years. The Asian market was in its developmental stage, and we had an opportunity to position Starbucks as a leader in a new industry, and in a sense, educate a market about the quality of coffee, the experience, and the idea of Starbucks becoming the third place between home and work in those countries.[24]

In most of its international markets, Starbucks worked with local business partners to help it set up supplier relationships, recruit talent, and understand market conditions. For instance, in Japan, it entered into a joint venture with national food, apparel, and lifestyle retailer Sazaby, and in Shanghai and Taiwan, with Taiwanese food conglomerate Uni-President Enterprises. Starbucks often ended up buying out its local partner when a joint venture was successful and the market had demonstrated potential for growth.[25]

In most new countries, Starbucks priced its products at U.S. levels and tailored its offerings to local preferences.[26] For instance, it offered tea in Japan and China, Turkish coffee in Turkey, and freshly squeezed orange juice in Spain. By September 2012, the company had over 18,000 stores across 62 countries and annual net revenues of $13.3 billion. Its leading international markets, apart from Canada, were Japan, the U.K., and China, and its international business had been profitable since 2004.[27] (See **Exhibits 8, 9, 10,** and **11** for details on Starbucks.)

Starbucks in China

Like India, China had historically been a tea-drinking nation. Not surprisingly, when Starbucks entered the country in 1999, many were skeptical. The company partnered with three different firms in Northern, Eastern and Southern China in order to obtain local expertise about consumer tastes in each region. It introduced beverages using popular local ingredients like green tea and soy, offered locally inspired foods, and gave each of its Chinese outlets the flexibility to choose from a variety of options based on local tastes.[28]

Starbucks also educated its Chinese consumers about coffee. A media report described the opening of Starbucks' first store in the city of Nanchang, in an agricultural province of China, in 2012:

> The grand opening kicked off with coffee education for local media. An ultra-perky barista named September told the packed room that "latte" means milk in Italian, so a latte is a coffee with milk. "American-style coffee is black coffee," she explained, "so if you order one in the morning you'll be awake and alert all day!" By early afternoon the café was buzzing and packed with customers. Some ordered with ease; others asked for suggestions. . . . One young man with a peach-fuzz mustache wearing a Bob Dylan T-shirt ordered a coffee—at room temperature. . . . The barista paused, then suggested an iced coffee with no ice. The Dylan fan seemed happy with that.[29]

Service was another factor in which Starbucks China distinguished itself. "Starbucks' service is on par if not higher than many five star hotels," elaborated Shaun Rein, managing director of CMR, a strategic market intelligence firm. "In interviews with several hundred consumers in Shanghai, the majority of them told my firm they actually preferred the taste of products from competitors, but continued to go to Starbucks because of the service."[30]

Unlike the U.S., where a large proportion of Starbucks outlets were kiosks offering takeout service, Starbucks China focused on the in-store experience, providing customers an upscale ambience. An article explained, "By offering comfortable environments in a market where few restaurants had air conditioning in the late 1990s, Starbucks [China] became a de facto meeting place for executives as well as for the gathering of friends."[31] Another added: "Starbucks is a place to socialize, and most Chinese visit in pairs or groups. Seating is configured to reflect that, with large community tables or living room-style setups of couches and armchairs clustered around a coffee table. . . . In China, stores must be spacious enough to accommodate consumers who linger for hours."[32]

As Starbucks expanded across China, the company opened a design center to ensure that the look and feel of its stores were in keeping with local arts and culture. An article reported:

> While a Starbucks in Shanghai or Beijing may look like one in New York, the new Starbucks for Fuzhou[j] has the style of a local courtyard home. It has sliding doors, soaring ceilings and a screen inspired by the black and white playing pieces of the chess-like Chinese game Weiqi. Outside, a big rock from the nearby stone mountains will be engraved with the Starbucks logo. . . . That's a big investment in effort and design for one store, but Starbucks sees it as serving as a flagship in a hub location with major growth potential and as an inspiration for future stores.[33]

To offset the higher costs of dine-in services, Starbucks positioned itself as a premium brand in China, with most of its stores charging around 50% to 75% more than its U.S. stores for a cup of coffee.[34] One article commented, "Carrying a Starbucks cup was seen as a status symbol, a way to demonstrate sophistication and the capability to afford a personal luxury for the up-and-coming middle class in China."[35] Another analyst added, "Many go to Starbucks [in China] not just for a cup of Frappuccino, but also for the 'Starbucks Experience' that makes them feel cool and trendy. Thus, Starbucks has established itself as an aspiration brand and is able to charge premium prices."[36] Starbucks China's pricing gave it higher per-store profitability than in the U.S.; in February 2012, the company's operating margins in Asia were 34.6%, compared with 21.8% in the U.S.[37]

Starbucks China also adapted its talent strategy to local conditions. For instance, Chinese parents held significant influence over their children's career decisions, and many had reservations about their children working at a coffee bar. To counter such apprehensions, the company launched a

[j] Fuzhou is the capital of the Fujian Province on the southeast coast of mainland China, and one of its largest cities.

"family forum" in 2012, where it invited the parents of its store employees to hear testimonies from those who had worked their way into management positions. Later, it held an annual meeting of parents of employees in Beijing and Shanghai, for which it registered 90% participation.[38]

Starbucks China focused initially on high-visibility, high-traffic locations in international hubs like Beijing, Shanghai, and Guangzhou, before moving into smaller cities; by October 2012, the company had grown to over 570 stores in 48 cities across the country. Starbucks expected China to become its second-largest market by 2014 and planned to have a total of 1,500 stores there by 2015. [39,40]

Starbucks in India

Starbucks had considered entering the Indian market since 2007, with reports suggesting that the company had explored partnerships with a number of Indian firms, including Future Group, a leading multibrand retailer, and Jubilant Foodworks, the master franchisee for Domino's Pizza in the country. None of these deals materialized. Schultz explained, "What a lot of people have asked is what took us so long to come to India. . . . Without finding the right partner, getting into a complex market like India would be very difficult."[41]

In January 2012, Starbucks and Tata Global Beverages, the world's second-largest branded tea company, owned by the Tata Group, announced a 50-50 joint venture, Tata Starbucks, to own and operate Starbucks cafés across the country. (See **Exhibit 12** for details on Tata Group's hotel and retail properties in India.) Saloni Nangia, president of consulting firm Technopak, commented, "Starbucks understands how to create the Starbucks experience. For the supply chain, which is the difficult part in India, the Tatas bring in complete understanding."[42]

Once the joint venture was formed, Starbucks worked with Tata Coffee to make a new blend of espresso roast for the Indian market and set up a roasting plant in India. The company spent several months working with Taj SATS, a catering business owned by the Tata Group, to create an offering for Indian consumers that included locally inspired dishes like the *tandoori* chicken sandwich and *elaichi mawa* croissant,[k] as well as a unique food item for each city. It engaged local craftsmen to help design its store furniture and fittings; sent its store managers to train in Singapore, Malaysia, and Thailand; and set up training centers in Mumbai and Delhi, where it trained café staff to prepare its beverages.

In October 2012, Starbucks opened its first store in India, a 4,500-square-foot retail outlet with plush wood and leather interiors, in an old gothic building in upscale South Mumbai. Unlike other U.S. chains, such as McDonald's, Starbucks added a distinctly Indian motif to the interiors. (See **Exhibit 13** for photos.) Schultz remarked:

> Unlike any of the existing competitors, the stores that we will open and design will create a destination because of the elegance and the style of the store and its size. . . . We want to create a coffee experience that is a stunning experience in terms of quality. We want to create a physical environment that does not exist, and when people see it, it will become the third place [third most-popular place after home and work].[43]

By April 2013, Starbucks had 11 stores in India, split between Mumbai and New Delhi. The company was considering opening additional stores in Taj hotels, Westside department stores, high-street locations, airports, railway stations, office buildings, and university campuses.[44] "We think over time India will be one of the largest markets in the world for Starbucks," Schultz concluded.[45]

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[k] Made with popular local ingredients like cardamom and condensed milk.

CCD: Face-to-Face with Starbucks

In its opening week, Starbucks' flagship store in South Mumbai attracted enormous media coverage and long queues of customers. Of course, CCD was watching closely. CCD executives estimated that the new flagship store was generating US$2,000 to $4,000 per day, compared to US$2,000 at CCD's best stores. The initial reaction to Starbucks was overwhelming: the press coverage was massive, and "the average waiting time stretching to over half-an-hour."[46] Schultz confirmed, "All three stores [in Mumbai] are exceeding our loftiest expectations."[47]

Early Consumer Interest

CCD management was not surprised that Starbucks' international appeal would work to the company's advantage. As one CCD executive explained, "Indians have a tremendous curiosity of foreign brands. They like to seek out and experiment with any new brand that enters the country. The retail industry currently grabs major headlines in the country, which also helps in increasing awareness." At the same time, others felt that the curiosity around Starbucks might be short-lived. When McDonald's entered India, for example, the queues were very long for months. But eventually, the excess enthusiasm faded.

Starbucks' Entry Strategy

It was clearly too early to assess Starbucks' likelihood of success. After only six months and 11 stores opened, anything could happen. While most CCD executives felt that Starbucks India would face many challenges, they also recognized that Starbucks would be a tough competitor. Tata, for example, was an excellent partner for Starbucks: in addition to the many premium locations it could offer Starbucks, Tata was well connected, which allowed it to open stores quicker than other foreign brands could. Since Tata was also a large coffee producer, it gave Starbucks the ability to offer a local coffee brand rather than import coffee at a higher price.

Starbucks' initial pricing for coffee was aggressive. The benchmark for coffee chains was the price of a cappuccino, and Rs. 100 (about US$2) was perceived as a psychological barrier. Starbucks basic cappuccino was Rs. 95, compared to Rs. 66 at a CCD café. Starbucks also offered premium food and prided itself on high service standards. Food price points were relatively high for India: a sandwich might cost Rs. 125, compared with Rs. 85 at CCD. For service, Starbucks brought its global service practices to India and offered twice the pay level as CCD. In fact, in just six months, 40 people—perhaps 15%–17% of Starbucks Indian staff—were poached from CCD with the lure of higher salaries. However, Starbucks had not succeeded in poaching any of CCD's management talent, despite calls from headhunters. CCD's great scale offered better management job opportunities than Starbucks.

Starbucks was opening about two stores a month, but CCD executives believed that store openings would accelerate. Starbucks had opened a number of its first stores in close proximity to a CCD outlet in prime locations. According to Madhav, "Volumes at those CCD cafés were up as much as 15%–25%." One of the big questions was whether the market would naturally segment: in the first six months, Starbucks attracted a broad cross-section of customers, with a heavy dose of working professionals over age 25. CCD, by comparison, was weighted toward teenagers and college students under 25. As one CCD executive noted:

> Since Starbucks is 50% more expensive than CCD in India, it will attract tourists and well-traveled people who've been to Starbucks elsewhere. They will differentiate themselves around being an exclusive, premium provider, and probably won't venture beyond the top

> seven cities for the next three to four years. The younger lot will go to Starbucks once or twice because they want to talk about it, but it's not an affordable price point for them. If they do not come, there's no great growth for Starbucks. India is a pyramidal market. The angle of the pyramid might change, but the pyramid will remain. [See **Exhibit 14** for the age distribution in India.]

Siddhartha added:

> Foreign brands coming to India today are concentrating on the top 5%–7% of the market, while we are targeting 40% of it. Starbucks' average bill for two will be approximately Rs. 450–600, [$8–$11] whereas at CCD, it will be Rs. 175 [$3]. I may spend Rs. 600 twice, but not on a daily basis. As Indians, we are slightly price sensitive.

While Starbucks was clearly expensive for the average Indian, the big unknown was if and how Starbucks might induce a shift in consuming patterns. In many other countries, Starbucks had raised the willingness to pay for premium coffee. Starbucks' focus on service, product innovation, and new customer segments, such as professionals, had expanded the U.S. and many non-U.S. markets.

Customer Service

Service levels were one of CCD's biggest challenges. Siddhartha commented, "Four years ago, if you had asked me, I would've said my service is good, but now I am getting hit by competition, and I know my service is not up to expectation." A CCD executive added:

> There are probably a couple of people in each of our cafés who are very articulate, and are able to connect with customers, but otherwise, the experience is very transactional. The brand connects, but the people don't. We're getting people from small towns, and it's difficult for them to adjust to our kind of consumer.

However, some questioned whether Starbucks would face the same constraints. A CCD executive explained:

> A major problem for Starbucks in India will be maintaining service levels. The kind of people who serve me at Starbucks in the U.S. or Europe are vastly different from the kind of people who serve me in India. Providing great service in 10 stores may be relatively easy. How about 100, 200, or 300 stores? Will they be able to maintain high service levels in all Indian cities at all points of time?

Real Estate

High (some people would say exorbitant) real estate prices in India remained a challenge for everyone in the retail industry in India's major cities. CCD executives felt that the company had an advantage because it got into many high-street locations early, at relatively low prices. However, according to industry insiders, some malls and prime locations such as Delhi airport had invited Starbucks to be an anchor tenant at relatively lower rents because they felt that its presence would result in more walk-in customers. As a result, Starbucks was expected to quickly roll out stores at such locations.

Over the longer term, however, Starbucks would face the same real estate prices as CCD. "Once Starbucks gets to 100 or 150 locations," noted a CCD executive, "the easy expansion is over. Starbucks will have to start looking for type 'b' and type 'c' locations, where there will be no special deals." In a secondary location, Starbucks would face higher operating costs.

Looking Ahead

Siddhartha finished the cappuccino sitting on his desk. CCD had an enormous head start in the Indian market, and he was very optimistic that CCD was well positioned to take on all foreign brands in the local market. Siddhartha even commented that competition was good for CCD: it was being pushed to improve. At the same time, Siddhartha and Madhav agreed that "a slight course correction" was probably in order. CCD should improve both the breadth and quality of its food and beverage offerings, upgrade interiors, and improve service levels through greater training. In addition, CCD was big enough in 2013 that it could start spending to build its brand. For the first time ever, CCD would spend about $3 million for advertising. In addition, all new stores would be larger (about 1,000–1,200 square feet, similar to Starbucks), and the company planned to upgrade about 150 stores per year. (A store upgrade, which ranged from new furniture and counters to a completely new interior, cost up to 65% of the original capital costs to outfit a store.) About 1,000 stores needed to be upgraded.

The real debate was whether this was sufficient. "If pushed to the wall," noted Madhav, "we could be much more aggressive." What if Starbucks' trajectory in India was similar to that in China or the United States? Madhav commented that CCD could easily respond: instead of 3% of CCD stores being Squares and Lounges, maybe they should raise number of Squares and Lounges to 25% or 30% of the portfolio? This would mean converting more cafés into Lounges, as well as building more Lounges and Squares. Instead of upgrading 150 stores per year, maybe they should upgrade 200 or 300 stores per year. And instead of spending only $3 million on advertising, perhaps they should double or triple brand spending.

Neither Siddhartha nor Madhav had all the answers: Starbucks had opened only 11 stores in the vast Indian market. It was much too early to predict how the coffee wars would play out. The "slight course correction" was already underway, but if CCD wanted to take a more aggressive approach, it could not wait long. It would take time (and a lot of investment) to implement the "pushed to the wall" strategy. Both Siddhartha and Madhav believed a decision on whether to be more aggressive should be made by year-end 2013.

Exhibit 1 India's Coffee Market

	Market Size	Growth
Food service (cafés)	$230 million (March 2012)	13%–14%
Instant coffee (retail)	$265 million (2011)	9.9%
Specialty coffee (fresh coffee and beans) (retail)	$197 million (2011)	19.2%

Source: Compiled from Euromonitor, Technopak.

Exhibit 2 India's Specialist Coffee Chains

	Launch	Origin	Partner	Stores	Small Cappuccino Cost (April 2013)
Café Coffee Day	1996	India's ABCTCL Exports	None	1,469	66
Barista Lavazza	2000	Since 2007, part of Lavazza, Italy's largest coffee company	Established by India's Barista Coffee company; currently owned by Lavazza	175	88
Costa Coffee	2010	U.K.-based Costa Coffee	Jaipuria-promoted Devyani International	100	95
Mocha Café	2001	India's Impressario entertainment & hospitality	n/a	18	70
Coffee Bean & Tea Leaf	2008	U.S.-based Coffee Bean & Tea Leaf	Pan India foods	17	105
Gloria Jean's Coffees	2008	Australia-based Gloria Jean's	UAE-based Landmark Group	17	107
Starbucks	October 2012	U.S.-based Starbucks Coffee Company	India's Tata Group	11	95
Bru World Café	2011	Multinational Hindustan Unilever	n/a	7	129
Di Bella	early 2012	Australia-based Di Bella	Entrepreneur Sachin Sabharwal	6	106
Dunkin' Donuts	May 2012	U.S.-based Dunkin' Donuts	Jubilant Foodworks Ltd, operator of Domino's Pizza in India	5	90

Source: Technopak Consultants, http://www.business-standard.com/india/news/starbucks-effect-barista-ropes-in-rina-dhaka-forface-lift/491342/, accessed June 2013.

Notes: Café figures for CCD and Starbucks as of April 2013; and for competitors as of November 2012.

Exhibit 3 A CCD Café

Source: Company documents.

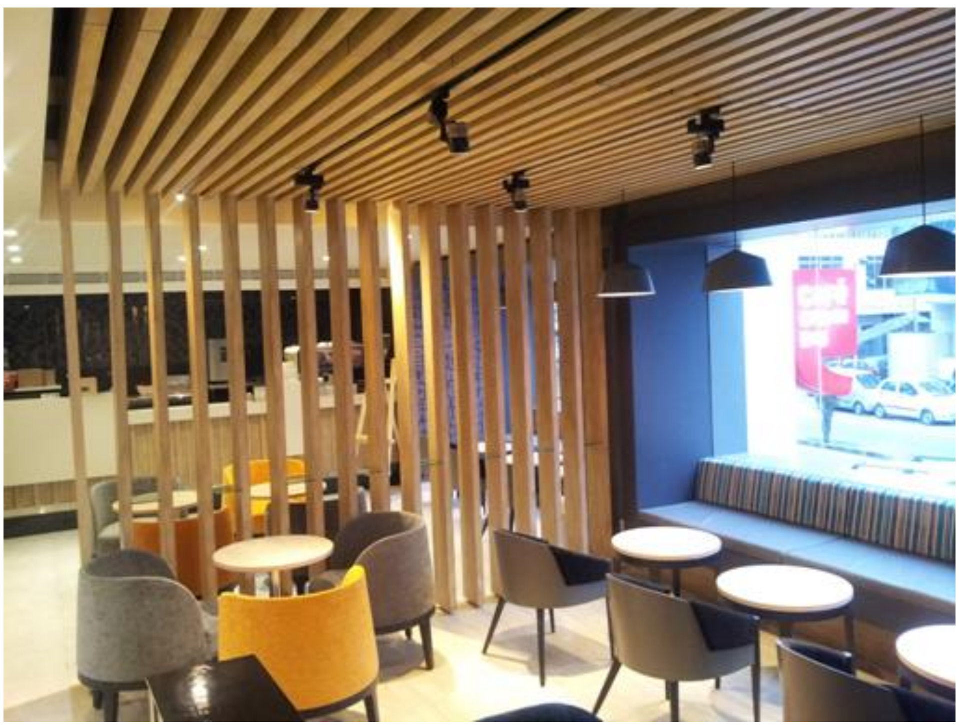
Exhibit 4 Economics of a CCD Café (February 2013)

	Amount ($)	Percent
Store setup costs	$85,000	
Monthly sales	$7,200	
Cost of goods	$2,520	35%
Rent	$1,368	19%
Salary	$936	13%
Electricity	$504	6%
EBITDA	$1,872	27%

Source: Company documents.

Note: Converted using an exchange rate of Rs. 50 for one U.S. dollar.

Exhibit 5 A CCD Lounge



Source: Company documents.

Exhibit 6 A CCD Square

Source: Casewriter.

Exhibit 7 CCD's Service Formats

Format	Target Customer	Size	Setup Costs	Menu	Numbers (April 2013)	Locations
Café	Under 30	800–1,000 sq. ft.	$85,000	Hot and cold beverages, ready-to-eat snacks: cold coffee, puffs, sandwiches	1,421	Metropolitan and small cities
Lounge	28–36		$130,000	Casual dining (hamburgers, pastas, pizzas)	46	Metropolitan cities
Square	30+ coffee connoisseur	2,500 sq. ft.	$190,000	Premium coffee and global cuisine (curries, waffles)	2	Metropolitan cities
Fresh and ground	Home coffee drinkers			Freshly ground coffee and coffee beans	450	Southern Indian cities
Coffee Day beverages	Institutions	n/a	n/a	Bean to cup coffee machines using fresh milk and roasted beans	22,000 machines/ 7,000 institutions	Corporate/institutional campuses

Source: Company documents.

Exhibit 8 Starbucks' Global Store Count

Region	Store Count
Americas	12,903
Europe, Middle East & Africa	1,869
China/Asia Pacific	3,294
Total Stores	18,066

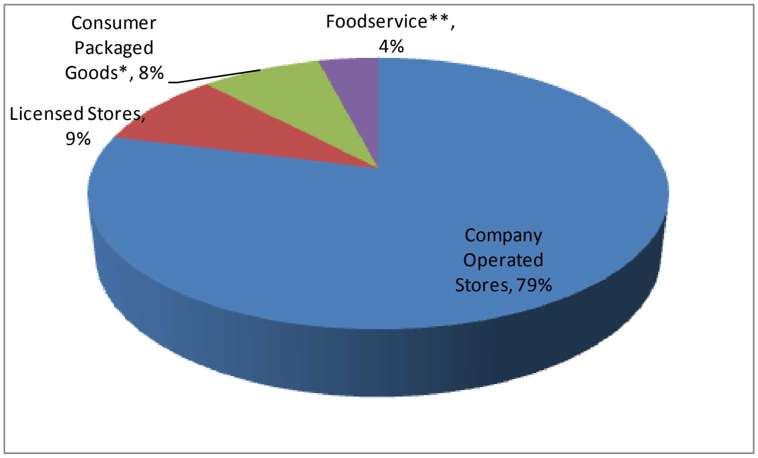
Source: Starbucks, 2012 Annual Report, p. 24.

Exhibit 9 Starbucks Financial Data (in millions, except per share data)

	Financial Year End September 30, 2012
Results of Operations	
Net revenues	
Company-operated stores	$10,534.5
Licensed stores	1,210.3
CPG, foodservice and other	1,554.7
Total net revenues	$13,299.5
Operating income	$1,997.4
Net earnings attributable to Starbucks	1,383.8
EPS – diluted	1.79
Capital expenditures	856.2
Balance Sheet	
Total assets	$8,219.2
Long-term debt	549.6
Shareholders' equity	5,109.0

Source: Starbucks, 2012 Annual Report, p. 22.

Exhibit 10 Starbucks Revenue Breakdown (September 2012)



Source: Adapted from Starbucks, 2012 Annual Report.

* Includes sales of packaged coffee, tea, and ready-to-drink beverages to grocery, warehouse club, and specialty retail stores.

** Includes sales of whole bean and ground coffee, teas, instant coffee, etc., to companies that service corporate, education, healthcare, hotel, restaurant, airline, and other.

Exhibit 11 CCD and Starbucks' In-Store Sales Mix

Product Type	CCD	Starbucks (globally)
Beverages	60%	75%
Food	35%	19%
Packaged coffee and other merchandise	5%	6%
Total	100%	100%

Source: Café Coffee Day; Starbucks, 2012 Annual Report.

Exhibit 12 Tata Group's Hotel and Retail Properties in India

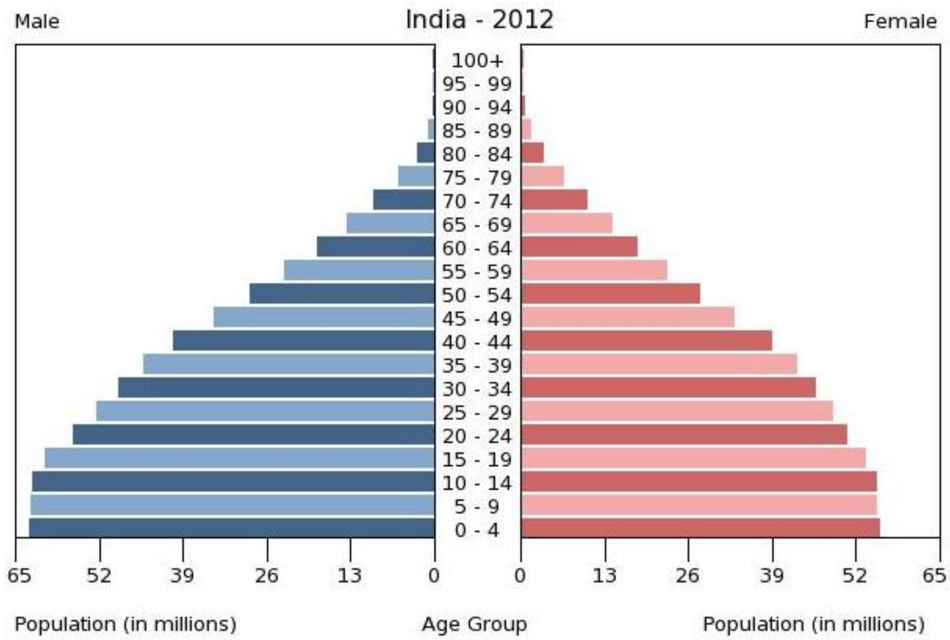
Chain	Number of Properties
Taj Hotels	76 hotels across India
Westside Department Stores	74 stores across 26 cities
Chroma Electronics Stores	Over 75 stores across India

Sources: www.tajhotels.com; www.mywestside.com; http://www.efytimes.com/e1/fullnews.asp?edid=70540, accessed June 2013.

Exhibit 13 Starbucks' First Store in India

Source: Casewriter.

Exhibit 14 Age Distribution of Indian Population



Source: *The World Factbook*, https://www.cia.gov/library/publications/the-world-factbook/population/population template_IN.html.

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