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9-504-016
REV: JULY 10, 2006

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Starbucks: Delivering Customer Service

In late 2002, Christine Day, Starbucks' senior vice president of administration in North America, sat in the seventh-floor conference room of Starbucks' Seattle headquarters and reached for her second cup of toffee-nut latte. The handcrafted beverage—a buttery, toffee-nut flavored espresso concoction topped with whipped cream and toffee sprinkles—had become a regular afternoon indulgence for Day ever since its introduction earlier that year.

As she waited for her colleagues to join her, Day reflected on the company's recent performance. While other retailers were still reeling from the post-9/11 recession, Starbucks was enjoying its 11th consecutive year of 5% or higher comparable store sales growth, prompting its founder and chairman, Howard Schultz, to declare: "I think we've demonstrated that we are close to a recession-proof product."[1]

Day, however, was not feeling nearly as sanguine, in part because Starbucks' most recent market research had revealed some unexpected findings. "We've always taken great pride in our retail service," said Day, "but according to the data, we're not always meeting our customers' expectations in the area of customer satisfaction."

As a result of these concerns, Day and her associates had come up with a plan to invest an additional $40 million annually in the company's 4,500 stores, which would allow each store to add the equivalent of 20 hours of labor a week. "The idea is to improve speed-of-service and thereby increase customer satisfaction," said Day.

In two days, Day was due to make a final recommendation to both Schultz and Orin Smith, Starbucks' CEO, about whether the company should move forward with the plan. "The investment is the EPS [earnings per share] equivalent of almost seven cents a share," said Day. In preparation for her meeting with Schultz and Smith, Day had asked one of her associates to help her think through the implications of the plan. Day noted, "The real question is, do we believe what our customers are telling us about what constitutes 'excellent' customer service? And if we deliver it, what will the impact be on our sales and profitability?"

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[1] Jake Batsell, "A Grande Decade for Starbucks," *The Seattle Times*, June 26, 2002.

Company Background

The story of how Howard Schultz managed to transform a commodity into an upscale cultural phenomenon has become the stuff of legends. In 1971, three coffee fanatics—Gerald Baldwin, Gordon Bowker, and Ziev Siegl—opened a small coffee shop in Seattle's Pike Place Market. The shop specialized in selling whole arabica beans to a niche market of coffee purists.

In 1982, Schultz joined the Starbucks marketing team; shortly thereafter, he traveled to Italy, where he became fascinated with Milan's coffee culture, in particular, the role the neighborhood espresso bars played in Italians' everyday social lives. Upon his return, the inspired Schultz convinced the company to set up an espresso bar in the corner of its only downtown Seattle shop. As Schultz explained, the bar became the prototype for his long-term vision:

> The idea was to create a chain of coffeehouses that would become America's "third place." At the time, most Americans had two places in their lives—home and work. But I believed that people needed another place, a place where they could go to relax and enjoy others, or just be by themselves. I envisioned a place that would be separate from home or work, a place that would mean different things to different people.

A few years later, Schultz got his chance when Starbucks' founders agreed to sell him the company. As soon as Schultz took over, he immediately began opening new stores. The stores sold whole beans and premium-priced coffee beverages by the cup and catered primarily to affluent, well-educated, white-collar patrons (skewed female) between the ages of 25 and 44. By 1992, the company had 140 such stores in the Northwest and Chicago and was successfully competing against other small-scale coffee chains such as Gloria Jean's Coffee Bean and Barnie's Coffee & Tea.

That same year, Schultz decided to take the company public. As he recalled, many Wall Street types were dubious about the idea: "They'd say, 'You mean, you're going to sell coffee for a dollar in a paper cup, with Italian names that no one in America can say? At a time in America when no one's drinking coffee? And I can get coffee at the local coffee shop or doughnut shop for 50 cents? Are you kidding me?'"[2]

Ignoring the skeptics, Schultz forged ahead with the public offering, raising $25 million in the process. The proceeds allowed Starbucks to open more stores across the nation.

By 2002, Schultz had unequivocally established Starbucks as the dominant specialty-coffee brand in North America. Sales had climbed at a compound annual growth rate (CAGR) of 40% since the company had gone public, and net earnings had risen at a CAGR of 50%. The company was now serving 20 million unique customers in well over 5,000 stores around the globe and was opening on average three new stores a day. (See **Exhibits 1–3** for company financials and store growth over time.)

What made Starbucks' success even more impressive was that the company had spent almost nothing on advertising to achieve it. North American marketing primarily consisted of point-of-sale materials and local-store marketing and was far less than the industry average. (Most fast-food chains had marketing budgets in the 3%–6% range.)

For his part, Schultz remained as chairman and chief global strategist in control of the company, handing over day-to-day operations in 2002 to CEO Orin Smith, a Harvard MBA (1967) who had joined the company in 1990.

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[2] Batsell.