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TALKING BUSINESS

Give Me a Double Shot of Starbucks Nostalgia

By [JOE NOCERA](#)

Is it possible that there are actually two Howard Schultzes lurking around [Starbucks](#) headquarters in Seattle? I think it is.

The first Howard Schultz is the man who has coffee in his veins. He's the one who bought what was then the tiny Starbucks company in 1987 and turned it into one of the dominant brands of the age. Starbucks coffee was a step above other coffee, and it also offered a "coffee experience" that made customers willing to pay \$4 for something that used to cost them 60 cents.

Starbucks was a place where people could hang out, read the paper, and make friends with the "baristas" behind the counter; Mr. Schultz used to call it the "third place," a respite from both the workplace and the home front. Starbucks had its own language and culture. Its part-time staff got stock options and health insurance. It didn't exploit its coffee growers. It had a huge social responsibility program. And Mr. Schultz, who is chairman of Starbucks, took deep pride in all the things that made Starbucks special.

Last week, this Mr. Schultz was on vivid display when an internal memo he wrote to his top executives was leaked to [Starbucksgossip.com](#). The memo is a cri de coeur from Mr. Schultz, a lament for what has been lost as Starbucks has grown from 6 stores in 1987 to more than 13,000 stores today. He pointed, for instance, to the company's decision some years ago to install automatic espresso machines, which, he wrote, "solved a major problem in terms of speed and service," but also made buying a cup of Starbucks coffee a more antiseptic experience.

He complained about the loss of aroma because the baristas no longer scooped fresh coffee beans from bins and ground them in front of customers. He said that streamlining the company's store designs had caused them to lose "the soul of the past and reflect a chain of stores vs. the warm feeling of a neighborhood store." He said that the Starbucks experience was becoming commoditized, and he urged the executive team to "go back to the core."

The memo was widely lauded as an example of an entrepreneur who understood the importance of recapturing what made his business special before it was too late. "While I wouldn't argue that the Starbucks brand is in its death knell, I would argue that the efficiencies and economies of scale have introduced a virus in need of serious care," wrote Mike Neiss on the [Web site of the Tom Peters Company](#). "And it looks like Howard Schultz just might be the healer they need."

Warren Bennis, the leadership guru who has served as an informal mentor to Mr. Schultz, said, "This is

something every successful chief executive should do every once in a while.”

But then there's the other Howard Schultz, the one who signed off on the very compromises he complained about in the memo, precisely because they would help the company grow faster. This second Howard Schultz can talk Wall Street's language: he goes on the quarterly conference calls and spits out data about same-store sales, return on investment, and, most of all, growth. Though it has lagged recently, his company's stock price has risen 5,000 percent since it went public in 1992, in large part because Mr. Schultz has been so fanatical about growth. It closed yesterday at \$29.88.

“Starbucks is the fastest-growing retail story of all time,” said John Glass, an analyst with CIBC. “It has grown faster than [McDonald's](#) ever did.”

This second Howard Schultz shows no signs of slowing down anytime soon. “I want to say this as loud as I possibly can,” he told Maria Bartiromo on CNBC last November, after Starbucks released its quarterly earnings. “Three to five years, 20 percent revenue growth, 20 to 25 percent earnings per-share growth. And we're headed to 40,000 stores.” Those are astounding goals for a company the size of Starbucks: no company in history has ever built 40,000 retail outlets. (McDonald's, by contrast, has 30,000 stores worldwide.) And 25 percent earnings growth is something only the most aggressive of growth companies shoot for.

The quandary Mr. Schultz faces, assuming there is only one of him, is that he wants two things that are incompatible. If he wants to recapture the soul of the old Starbucks, then he has to slow down the company's growth. But if he slows the growth, the stock will collapse. He has to choose. Truth is, though, Mr. Schultz has already chosen.

ONCE, maybe 10 years ago, Mr. Bennis asked Mr. Schultz why it was so important to him that Starbucks grow so rapidly. “He said something to the effect that if he didn't do it, Starbucks could be cannibalized by another chain that would wipe it out,” Mr. Bennis told me.

As I discovered when I asked around, Mr. Schultz is an enormously competitive businessman; I wound up thinking that the idea of relentless growth is just as powerful a driving force for him as coffee itself. In the memo, he complained that Starbucks' competitors have become emboldened to go after Starbucks customers. “This must be eradicated,” were the startling words he used.

But to give him his due, Mr. Schultz has always struggled with the problem of trying to stay true to the company's roots while growing aggressively. “Last October or November, he made comments very similar to the thoughts in the memo at a dinner with investors,” Mr. Glass said. And according to Anne Saunders, Starbucks' senior vice president for global brand strategy, what he wrote in the memo was nothing Starbucks executives hadn't heard from him many times in the past. “Howard is often challenging us,” she said.

“We have grown as a company because we have chosen to do business in a different kind of way,” she continued. “If growth comes from doing things that are out of whack, then it is not the right kind of

growth.” Ms. Saunders went on to say that she, and the rest of the company’s managers, believed that the company had grown in ways that remained compatible with its culture.

Maybe. But from where I’m sitting, it just looks as though whenever push has come to shove, the growth imperative has usually won out.

Take, for instance, food. “I remember when Starbucks went public,” said Ron Paul of Technomic, a food retail consulting firm. “I went to one of the roadshow presentations. Howard said that they would never serve food. He thought it would dilute the experience.” (A Starbucks spokeswoman said Mr. Schultz was pointing out that Starbucks was a coffee company, not a restaurant chain.)

But one of the most important metrics for Wall Street is same-store sales increases. If growth is being generated purely from the opening of new stores — and not from increased sales in stores that are already open — that’s viewed as a bad sign. It means that once the company runs out of places to put stores, it will stop growing. For Starbucks, there was always going to be a limit to how much coffee it could sell in any one location, so to goose same-store sales, it began selling food. (Not very good food either, but that’s a whole other story.) Most recently, it has begun selling hot breakfast sandwiches in a number of markets, yet another move it would never have made, say, five years ago. The same principle applies to music, to books and all the other things Starbucks now sells in its stores.

The food and brand consultants I spoke to were unanimous in their feeling that Starbucks had hurt itself by expanding so far beyond its coffee and coffeehouse roots — and that it needed to return to those roots. “He is right that Starbucks is losing its soul,” said Harvey Hartman, who heads the Hartman Group in Bellevue, Wash. “They were built on the coffee experience, and by moving so far beyond that, they are jeopardizing everything else.”

Robert Passikoff, president of the brand consultant Brand Keys, said that Starbucks had taken its eye off the brand. “In trying to migrate from a coffee brand to a lifestyle brand, there has been a certain brand dilution.” He agreed that the “whole European coffeehouse experience” was no longer how people thought about Starbucks, to the company’s detriment. Mr. Passikoff’s firm just completed a survey of 20,000 people by phone and in person that showed that Dunkin’ Donuts now had higher customer loyalty than Starbucks. He also pointed out that Consumer Reports recently asserted that McDonald’s coffee was superior to Starbucks’s. Both Mr. Passikoff and Mr. Hartman felt that the memo made a great deal of sense.

The Wall Street folks I spoke to, though, saw the memo differently — as a kind of longing for a memory that will never return. “When you grow as big and as fast as they have, you have to make compromises,” said Howard Penney, who covers the company for Prudential. “The complexity of the menu has changed dramatically since it first opened,” he said. That complexity required automation and other techniques to keep waits for coffee from being too long. (As anyone who buys Starbucks coffee in New York knows, the company doesn’t always succeed.)

Mr. Glass of CIBC said: “If it remained a coffee destination and nothing else, same-store sales would not increase. It’s a public company. Their job is to make money for the shareholders by selling more stuff.” Both Mr. Glass and Mr. Penney pointed out that Starbucks plans to open 2,400 stores this year. That’s more than six new stores every day. Tell me how you’re going to do that if the baristas start grinding coffee by hand again?

Of course, that’s never going to happen, as Ms. Saunders of Starbucks quickly acknowledged when we spoke. “Our business has never been better,” she said. “We are really doing well.” But the company didn’t want to ever rest on its laurels — and it didn’t want to sacrifice what made it special just for the sake of growth, she said. “The question is always, How do you keep things in balance?”

For lovers of Starbucks, I suppose it’s comforting to know that Mr. Schultz and his team sit around worrying about whether they are watering down the customer experience. But it would be even more comforting if they actually did something about it. Because someday, the growth will slow and the stock will slide — that’s inevitable. And how will customers feel if, when that happens, their customer experience has been turned into a drive-through window, just like McDonald’s.

Oops, I forgot. Starbucks has already started putting in drive-through windows.

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