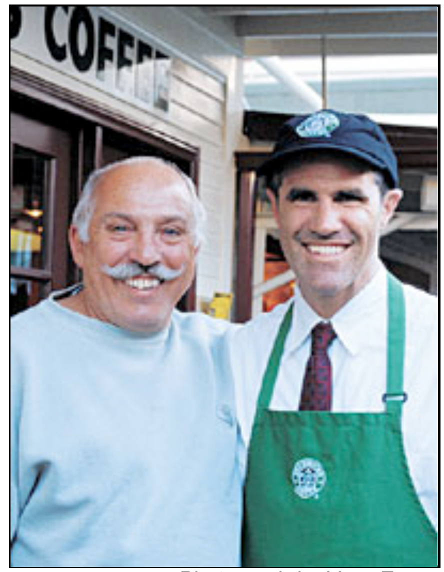
strategy+business is published by the global commercial consulting firm Booz & Company.

Strategy & Competition

The Barista Principle — Starbucks and the Rise of Relational Capital

By Ranjay Gulati, Sarah Huffman, and Gary Neilson

From coffee bar to caffeine kingdom, Starbucks proves relationships are as important as physical assets.



Photograph by Vern Evans

In February 2002, inside the Seattle headquarters of the Starbucks Corporation, Chas Hermann, the vice president of planning, reflected on a difficulty all too rare in even the best of times, and certainly unusual during the kind of economic downturn the United States was enduring. Starbucks, the leading retailer, roaster, and brand of specialty coffee in the world, had expanded at a furious pace since it was purchased and transformed by Howard Schultz 15 years earlier. The company had grown from a local Seattle company to an enterprise with more than 5,000 retail stores on four continents. In 2001, the company had opened a record number of stores, had posted its highest net earnings in history despite the recession, and had been named the fastest-growing global brand by *Business Week.* With Starbucks planning to open approximately 1,200 stores in fiscal 2002, Mr. Hermann wondered, “How do we continue to grow the business?”

The speed with which Starbucks had managed its ascent was almost as remarkable as the changes it had wrought in traditional conceptions of brand marketing. At a time of rising perceptions of parity across most product and service categories throughout the developed world, Starbucks had managed to take one of the world’s oldest commodities and turn it into a differentiated, lasting, value-laden brand. Moreover, the company had done this without relying on some of brand marketing’s most venerable tools, including an extensive advertising and promotions budget. Over a 20-year period, Starbucks spent approximately $20 million total on advertising, an average of $1 million per year; in contrast, according to a 2001 *Business Week* analysis of the top 100 brands, Proctor & Gamble Company’s Pampers brand — which ranked 92, four places below Starbucks, on the list — spends $30 million *annually* on advertising.

How did a small Seattle company turn itself into a global synonym for java and joe? The answer, we believe, lies with an ingredient as central to Starbucks’s business as the premium coffee beans it roasts: Relationships. “Starbucks starts and ends with core values … [and] the core values emanate from and around relationships with people,” says Anne McGonigle, the company’s vice president for special projects.

Starbucks is not the only company that firmly believes that an emphasis on relationships should be more than simply management rhetoric. Nor is it the only company that has profitably put this belief into practice. Our research indicates that relationships are indeed central to the sustained, superior performance of many of the world’s most successful companies. In late 2001, researchers at Booz Allen Hamilton and Northwestern University’s Kellogg School of Management surveyed 113 executives at a representative sample of Fortune 1000 companies and found that winning companies define and deploy relationships in a consistent, specific, multifaceted manner. Although some companies will dub any concluded business deal a relationship, top-performing companies focus extraordinary, enterprise-wide energy on moving beyond a transactional mind-set as they develop trust-based, mutually beneficial, and long-term associations, specifically with four key constituencies: customers, suppliers, alliance partners, and their own employees. Starbucks, we believe, exemplifies this new model of the relationship-centric organization. “The culture is very relationship-oriented,” says Michelle Gass, vice president of beverage. “It’s built on trust. We talk about partnerships and mean it in every sense of the word."

The relationships with these four constituencies are so valuable that they should be considered, collectively, a core asset of a firm. We call this asset "relational capital," and define it as the value of a firm's network of relationships with its customers, suppliers, alliance partners, and employees.

As vertically integrated companies refocus on their core businesses, they become increasingly reliant on their ties to these critical stakeholders — involving customers in product/solution development, sharing more information with vendors, building wider and longer bridges with alliance partners, and demonstrating these same behaviors within their own organizations, at every level. Historically, companies have developed great expertise in, and elaborate processes for, managing physical assets. As the knowledge economy takes hold globally, companies should follow the lead of Starbucks, and apply the same disciplined approach to managing their network of relationships.

Building the Business

When the first Starbucks opened in Seattle's Pike Place Market in 1971, coffee consumption in the United States had been declining after reaching its peak in the 1960s, when 75 percent of the population drank the brew. The level of coffee consumption continued to fall until the 1980s, and has since remained relatively stable. Today, 52 percent of the adult population in the United States (107 million people) drink coffee daily, averaging 3.3 cups a day. An additional 28 percent, or 57 million people, drink coffee occasionally. (Europeans consume two to three times more than Americans.)

Although overall coffee consumption had declined, the three college friends who founded Starbucks 31 years ago had tapped into a segment of the industry that would explode over the next several decades. Since Starbucks began to sell gourmet coffee by the pound, demand for specialty coffees — including gourmet, flavored, and organically grown blends — has been rising steadily. The number of gourmet coffee drinkers grew from 4.5 million in 1993 to 21 million in 1999.

There was certainly a coffee cult brewing for years in the Pacific Northwest, but the growth of coffeehouses such as Starbucks clearly helped spark even greater national demand for premium coffee by increasing consumer awareness and interest. For that, the industry — and, potentially, other marketers mired in slow-growth categories — can thank Howard Schultz.

In 1982, Mr. Schultz was the vice president and general manager of U.S. operations for Perstorp, a Swedish kitchen equipment and housewares company. He noticed that one of his accounts, a small Seattle coffee retailer, was ordering large numbers of a manual drip coffeemaker. Intrigued, Mr. Schultz flew out to meet the owners and had his first introduction to freshly brewed, whole-bean coffee. He was hooked by the experience. "There was something magic about it," Mr. Schultz wrote in his 1997 memoir, *Pour Your Heart into It,* "a passion and authenticity I had never experienced in business." Shortly thereafter, Mr. Schultz joined Starbucks as director of marketing and retail operations.

In 1983, Mr. Schultz took a trip to Italy that transformed his vision for the company. He was struck by the centrality of coffee bars to Italian life, and envisioned a similar concept for Starbucks. He pictured a company that would become a part of its customers' lives — that would, in Mr. Schultz's words, become the "third place" in their daily existence — a familiar and welcoming refuge from work or home where they could relax in a safe public setting and enjoy a sense of community.

The owners of Starbucks, however, did not share his vision, so in 1985 Mr. Schultz left the company and founded his own coffee bar, christened Il Giornale, which means "daily" in Italian. By 1987, Il Giornale had three locations. That same year, learning that his old employers were selling the Seattle stores, roasting plant, and brand name, Mr. Schultz returned to his investors and others in the Seattle business community to help raise the $4 million necessary to buy out his former colleagues. Mr. Schultz became the major shareholder and the CEO of Starbucks.

Starbucks's initial growth was aided by the early strategy adopted and key hires made by Mr. Schultz. The company pursued a first-to-market strategy, expanding throughout the Pacific Northwest and then to Chicago and California, proving that its concept was viable beyond Seattle. Mr. Schultz hired experienced manager Howard Behar, whose background was in retail furniture, as head of the company's retail operations, and Orin Smith as chief financial officer. With a Harvard MBA and 13 years of consulting experience at Deloitte & Touche, Mr. Smith brought discipline to Starbucks without smothering its entrepreneurial spirit. (In June 2000, Mr. Smith was promoted to president and CEO, and Mr. Schultz became chief global strategist and chairman of the board.)

By 1990, Starbucks had turned a profit, but Mr. Schultz's ambitious growth plans required a constant infusion of cash. He disdained borrowing from banks and refused to raise funds by franchising — he saw no point in carefully selecting and roasting beans only to have the ultimate product ruined by inattention to detail at the store level. This decision led Starbucks to pursue the capital-intensive strategy of owning what is now a majority of its U.S. stores, and necessitated taking the company public. On June 26, 1992, Starbucks, trading on the Nasdaq under the symbol SBUX, implemented an IPO for 2.1 million shares at $17 a share, raising $28 million in net proceeds to further fuel the company's expansion. After the IPO, Starbucks would return to the markets to raise additional capital.

Starbucks relied primarily on a cluster strategy as it expanded throughout the U.S., moving into a major urban market and opening up stores in close proximity to one other. Each urban market would become the starting point for further expansion into suburbs and smaller metro areas, following a hub-and-spoke pattern. Although some cannibalization was inevitable, the company believed that opening multiple stores in the same area helped build the brand and also enhanced convenience for its customers. Because Starbucks utilized very little traditional advertising, it relied heavily on the actual stores to increase awareness of the brand. And multiple locations made it easier for customers to get Starbucks wherever they were. Furthermore, since the company owned its stores, it did not have to worry about answering to unhappy franchisees about the closeness of some of its locations. By 1996, Starbucks had more than 1,000 stores in the U.S.

That same year, Starbucks initiated its global expansion, opening its first international store in Tokyo, Japan. The success of Starbucks in a country where green tea was the national drink indicated the concept could work in other cultures as well. By 2002, Starbucks had stores on four continents.

At the end of fiscal 2001, profits had grown 32 percent to $181.2 million on sales of $2.6 billion, from profits of $94.6 million on sales of $2.2 billion in 2000. Company-operated retail stores accounted for approximately 84 percent of net revenues in 2001, with the balance coming from Starbucks's specialty operations, which include business alliances, international retail store licensing, grocery channel licensing, warehouse club accounts, direct-to-consumer joint ventures, and other initiatives. By early 2002, Starbucks was serving an average of 18 million customers a week worldwide, and new stores were opening daily.

Mr. Schultz and the Baristas

A key factor contributing to this success has been Starbucks's acknowledgment of the critical importance of its relationships, particularly with its employees. "We can be extremely profitable and competitive, with a highly regarded brand, and also be respected for treating our people well," Mr. Schultz wrote in his memoir. "In the end, it's not only possible to do both, but you can't really do one without the other."

The realization was neither accidental nor gradual. From the Italy trip that inspired his vision for Starbucks, Mr. Schultz had come away with an appreciation of the role the *baristas,* or coffee brewers, played in creating a comfortable, stable, and entertaining environment for the company's customers. That appreciation inspired him to develop a company culture — nurtured through promotions, compensation, and feedback mechanisms — that emphasized the importance of keeping employees motivated and content.

By regarding employees as communicators of its brand, Starbucks was manifestly taking a different path toward brand management than those normally followed by marketers. Money that could have been spent on advertising was invested in employee benefits and training. In 1988, Starbucks became one of the first companies to extend full health benefits to part-time employees. In 1991, it became the first privately owned U.S. company to offer a stock option program (titled Bean Stock) that included part-time employees. The company has realized substantial returns from its employee-relationship program: After Starbucks initiated the benefits changes, for example, the employee turnover rate dropped from as much as 175 percent a year to less than 65 percent.

Starbucks has buttressed the tangible incentives with an environment that encourages empowerment, communication, and collaboration. All employees, regardless of position, are called "partners" because they all receive stock options. Even the name chosen for its corporate headquarters, the Starbucks Support Center (SSC), reflects central management's role as an information and support provider, not an autocratic decision maker, for those working in the stores.

One way Starbucks empowers its partners is by decentralizing and regionalizing a significant amount of decision making. Many key decisions are made at the regional level, but individuals within each region work closely with the corporate teams on new store development, to help identify and select targeted areas to develop in each geographic area. These individuals also work with the operations team to finalize schematic plans, to ensure that stores are designed in a way that has relevance to the community.

Communicating a culture, values, and best practices across a company's internal boundaries is an essential part of building relational capital. Our research and analysis of the Fortune 1000 companies in our survey confirms that Starbucks is not alone in its relational approach to employees. Indeed, we find that top-quartile companies (those companies with the highest total return to shareholders for the five-year period 1996 to 2000), regardless of size, do this far better than do bottom-quartile companies (companies with a return to shareholders of less than 2 percent over the same period). Cross-business-unit communication is superior, with 59 percent of top-quartile companies focusing on it, versus 47 percent of bottom-quartile companies; overall goals and management values are shared across business units (81 percent versus 72 percent); and best practices are deployed across groups/locations (47 percent versus 27 percent). This elevated level of effective communication lays the groundwork for accelerated innovation, increasingly a requirement for success.

Starbucks epitomizes this approach. The SSC offers best practices for the field by completing a post-mortem after every quarter that results in the sharing of ideas among the four geographic "zones" that make up the company's North American market. This allows the company to utilize resources more efficiently by developing one program and offering it to all the Starbucks markets. For example, one zone came up with the idea of holding a Blended Beverage Rally to get employees fired up about the summer season's offerings. The employees learned about the products in a fun, reward-based setting and were given tangible incentives to sell the product. The event helped drive a noticeable sales increase in this zone, and, based on its success, the program was implemented on a national level.

This two-way flow of information between the zones and the SSC provides not only support, but also a basis for knowledge sharing throughout the company. Margie Giuntini, vice president of retail operations/ implementation, estimates that 80 percent of her corporate team members have worked at the store level. Some employees designated with high potential might "rotate in, rotate out," coming in from the field as district managers, working as project managers at the SSC, and then returning to the field at a higher level. The routine gives employees an opportunity to understand how the organization works at the SSC. Although Starbucks also gains valuable feedback from the field, "we don't want to keep them [at the SSC] for too long. Freshness from the field doesn't last long, so it's important to rotate quickly in order to get partners' and customers' perspective," says Ms. Giuntini, herself a former barista.

Feedback from employees at the store level is also critical in new product development. The Frappuccino blended beverage, which resulted in strong sales in its first year, was created by the efforts of Starbucks employees in Southern California. Tired of being besieged by requests for blended drinks and losing customers to competitors who were selling them, the partners decided to push for a blended beverage of their own and found upper-level managers who would help champion the product development process. Although Mr. Schultz was not initially enthusiastic about selling them, he later called Frappuccinos "the best mistake I never made."

Connecting with the Customer

The Frappuccino episode underscores the importance of the customer relationship to Starbucks's business. Starbucks considers its product to be not coffee, but the "coffeehouse experience," whether that experience is in the coffeehouse itself or replicated elsewhere. "We'll rarely talk just about the product," says Ms. Gass, vice president of beverage. "Starbucks is a place that allows the customer experience to happen. Things in the store are just props to the experience."

Keeping the customer's desires and expectations firmly in mind is a tactic characteristic of successful companies, our research found. More than two-thirds of the top-quartile firms we surveyed devote primary organizational focus to meeting customer expectations and extending long-term customer relationships. This is a much higher percentage than we found among bottom-quartile companies, which are far more focused on cutting costs and shedding underperforming assets. The highest-performing companies are ahead of their bottom-quartile peers in partnering with customers in the product development process (78 percent versus 63 percent), extending the longevity of their relationships with customers (66 percent versus 43 percent), and placing more ongoing focus on meeting customer expectations (91 percent versus 77 percent). The highest-performing companies also communicate better with customers, through both increased information sharing (97 percent versus 86 percent) and tighter computer network links (94 percent versus 80 percent).

Making a connection with customers at the store level is a key component of Starbucks's strategy, and particular emphasis is put on the relationship the customer has with the barista. Each barista receives 24 hours of training in customer service and basic retail skills, as well as "Coffee Knowledge" and "Brewing the Perfect Cup" classes. Baristas are taught to anticipate the customer's needs, and to make eye contact while carefully explaining the various flavors and blends.

Starbucks also enhances the customer relationship by soliciting feedback about patrons' experiences with Starbucks. Once a week, the leadership team at the SSC reads through raw, unedited customer comment cards. "Sometimes it can be shocking to hear what they have to say, but it brings us directly to the level of the customer," Ms. Giuntini says. "At the corporate level, it is easy to get disconnected from the customer."

The customer's relationship with Starbucks is taken into account when the company considers new product offerings to expand the brand. Starbucks has found that customers will "give it a license" to expand into different products or channels as long as it has first established a core relationship in the store. The customer has to be able to see the connection between the new product or service offering and the core essence of the Starbucks brand. For example, customers did not embrace ice cream flavors that had no connection to coffee.

By contrast, the recently introduced "Starbucks Card" stored-value card looks as if it is on its way to being accepted by consumers and partners because it eliminates the need for cash and credit cards, thus speeding transactions during busy times. The card also provides a foundation for a loyalty platform in the future.

Suppliers as Partners

Starbucks's relational model extends to the vendors and suppliers with whom it partners, from the farms that grow its beans to the bakeries that prepare its food to the company that manufactures its paper cups.

Here, too, Starbucks is following a pattern we saw with other successful companies in our survey on relational capital. As companies pinpoint where on the value chain they want to play and shed noncore operations, their relationships with suppliers become increasingly vital, especially where critical components and complementary offerings are concerned. Successful companies appreciate that one of the important distinctions between a business transaction and a true relationship is trust, and they expend tremendous energy developing ways to "institutionalize" that trust in their procurement processes. Consequently, as they are doing with customers, top-quartile companies are climbing a relationship ladder with suppliers, moving from isolated, arm's-length transactions for products and services to bundled and integrated offerings to, ultimately, strategic partnerships in which suppliers assume responsibility and accountability — in part or in full — for successful business outcomes. Top-quartile performers are distinguished by a greater focus on tightening computer network linkages (90 percent versus 80 percent of bottom-quartile companies) and extending the longevity of supply relationships (68 percent versus 57 percent).

Starbucks prefers to develop long-term relationships with its vendors and suppliers rather than simply buy from the lowest-cost provider. "We are looking for, first and foremost, quality; service is number two on our priority list, and cost is number three," says Buck Hendrix, vice president of purchasing. "Not that we want to pay more than we should — because we negotiate very hard — but we are not willing to compromise quality or service in order to get a lower price."

Selecting a supplier is a fairly long and formal process, and involves employees from various functions. The procurement operation leads and facilitates the process and provides structure, but employees from product development, category management, and business-unit operations typically also participate. This helps Starbucks understand the entire supply chain and how it ultimately affects the totality of operations. In addition to meeting specific quality requirements, the potential supplier is evaluated on its production capacity and ability to package and distribute the product. The coffee giant partners only with companies able to grow with it.

Starbucks prefers long-term relationships and is willing to work with suppliers to control prices and not to monitor on price alone because of the amount of time and money it takes to "develop" the vendor. "Losing a vendor is like losing an employee — you lose the money and time you put into training them," says John Yamin, the company's vice president of food. When making a long-term commitment to a supplier partner, Starbucks expects to be treated as a preferred customer in terms of pricing, profit percentage, and resources committed to its business. In return, the supplier partner receives significant volume sales and, given the rapid expansion of Starbucks, a base of business that is likely to grow. In addition, the supplier partner benefits from the Starbucks brand because the perception in the marketplace is that Starbucks's quality standards are very high. The company's long-term commitment to a supplier helps develop the supplier's reputation and helps it attract additional business.

Once the selection process has taken place, Starbucks works diligently to build a good working relationship with that supplier. During the first year of doing business together, senior management representatives from both companies often meet three or four times. After that, a strategic business review is conducted annually or semiannually to assess the relationship. The more strategic the product or product area, the more senior the individuals involved. The review typically includes a discussion and evaluation of the supplier's performance, as well as input from the supplier regarding how well Starbucks is working with it and what improvements can be made. In addition to evaluating the relationship, the parties frequently discuss such issues as manufacturing efficiencies, quality improvements, and new product development. Starbucks looks to the supplier to understand its business needs — including such varied issues as new product trends and developments, and optimization of cost and manufacturing efficiency — and attempts to foster a collaborative relationship.

Particularly vital is the relationship Starbucks has with its coffee growers. Starbucks fosters these relationships by paying a premium price for its coffee, as well as through its commitment to social and environmental issues in countries where the coffee is grown. Starbucks recently announced coffee sourcing guidelines to promote sustainability within the coffee-growing regions. Starbucks is a solid supporter of the Fair Trade movement, which ensures that coffee growers receive a livable wage by guaranteeing a set price for their beans. Starbucks's involvement with Fair Trade helps the coffee growers form cooperatives and links them directly to coffee importers, who are also encouraged to develop long-term relationships with the growers and to provide financial credit. By increasing the farmers' incomes, the cooperatives enable them to afford health care, education, and housing. In April 2000, Starbucks began offering Fair Trade certified coffee by the pound at thousands of retail stores across the U.S. In October 2001, Starbucks announced that it planned to buy a million pounds of Fair Trade coffee within the next 18 months.

Starbucks also has partnered with Conservation International, a nonprofit organization dedicated to conserving natural resources, on a project in Chiapas, Mexico, providing technical assistance to farmers to improve coffee bean quality and to encourage better environmental practices. "The most impressive [change] has been the increase in the quality of coffee produced by the farmers," says Bertha de la Cruz Rivera, the coordinator of the Chiapas Coffee Project. "The economic benefits that the cooperatives provide their members have also made them more stable organizations as the farmers have become more committed to them."

A License to Sell

Due in large part to Howard Schultz's careful nurturing and development of the Starbucks experience, the company has been able to leverage its increasingly strong brand through a variety of alliances to sell Starbucks coffee and develop new products with the Starbucks name.

The goal in establishing these relationships has been to continue to develop the brand outside the company's retail stores in order to reach customers through multiple points of contact, such as airports, bookstores, hotels, and grocery stores. On the surface, there is, as Mr. Schultz noted in his book, an "inherent contradiction" between the company's close control of the Starbucks retail store experience and the licensing of the brand. Compromised quality is always a risk.

The company's solution is to carefully select partners based on their reputation and commitment to quality, and to gauge their willingness to train their employees the Starbucks way. The principles are the same as those underlying supplier relationships. In a recent internal presentation, Brenda Maupin, director of strategic procurement operations, defined a strategic alliance as "a formal, long-term, ongoing business relationship between two companies with differing yet complementary competencies, similar values and guiding principles, for the purpose of creating an advantage over competitors by developing new business opportunities and broadening their joint scope of operations through collaboration and the mutual sharing of risks and rewards of the relationship."

Starbucks's specialty operations include business alliances, international retail store licensing, grocery channel licensing, warehouse club accounts, direct-to-consumer joint ventures, and other initiatives. Starbucks's first licensee was HMS Host, the largest airport concessionaire in the United States. Today, there are more than 900 licensed stores, at various venues including airports, Barnes & Noble bookstores, and grocery and mass-market retail chains such as Target, Albertson's, and Safeway stores. Other licensees, such as United Airlines and Marriott, have agreements to serve Starbucks coffee exclusively.

Starbucks has chosen to enter into licensing agreements rather than franchise its stores — another form of alliance — in order to retain more control. Franchising and licensing agreements are similar in that an outside entity is selling the brand. However, licensing provides Starbucks with more control of the brand because the licensee does not own the store, as a franchisee would; rather, licensees are "renting" the brand for a fee. Starbucks charges a royalty on gross sales and a licensing fee to start up the business. Starbucks also slightly marks up products it manufactures itself. Because Starbucks is motivated to see the partnering company make a profit, the coffee company does not make money on the sale of any associated products (such as milk) that it purchases for partners and transfers through its warehouses; instead, Starbucks charges partners only a fee to cover administrative costs.

One of Starbucks's most successful alliances has been with Barnes & Noble Inc. The companies established a relationship in 1993 when they realized that coffee and books were a natural fit: Barnes & Noble, already having embarked on a program to turn its superstores into centers of community life, decided it needed a café of some sort to create a more appealing ambiance for its customers. Originally, Starbucks opened its own branded stores inside Barnes & Noble bookstores in markets where Starbucks already had a retail presence. The Starbucks stores were company owned and operated, and had entrances both from the street and from within the bookstore. Both companies benefited from the arrangement: Starbucks drew customers into the bookstore during the morning when people usually do not shop for books; Barnes & Noble generated sales for Starbucks from customers taking a break from shopping.

Later, when Barnes & Noble began to build stores in areas where Starbucks was not already present or had no plans to expand, such as the Midwest, the companies collaborated to develop Barnes & Noble Cafés. These cafés are run by Barnes & Noble, which licenses the Starbucks brand and serves its coffee. Starbucks's Mr. Hendrix says that the licensing agreement was feasible because the companies had similar visions. "Their vision around the café was very similar to ours in terms of the service that was offered," he says. "Also, their standards have always been extremely high from a quality and customer-service perspective, so they were very good partners."

Conflict arose when Starbucks began to establish its own retail stores in the Midwest. Both companies wanted to ensure that they were not tripping over each other or locking each other out of retail space. Ultimately, the two companies worked through the differences. Starbucks now operates very few retail stores within Barnes & Noble; rather, Barnes & Noble Café operates more than 400 cafés that serve Starbucks coffee. The alliance worked out despite these challenges because both companies realized they were better off with each other than without. "Barnes & Noble realized they got a lot of value out of the Starbucks brand, and we realized that their being a customer had a huge value that we didn't want to go away," Mr. Hendrix says. "Internally, we said, 'What if that was someone else's coffee that was being served in those 400 stores? What would it mean to Starbucks as an organization and as a presence in those markets?' "

Although they are fewer in number, Starbucks also has established alliances with food service companies and consumer products companies. Food service companies such as Sodexho Inc. and Compass Group — which provide dining operations in a wide range of venues, including corporate, university, and hospital cafeterias — buy Starbucks coffee by the pound, brew it on Starbucks equipment, and serve it by the cup.

Alliances with consumer products companies, including Kraft, Pepsi, and Dreyer's, have allowed Starbucks to expand and distribute the brand in grocery channels, while sharing logistics costs and taking advantage of existing distribution networks. The Kraft partnership dates to 1998 and has made Starbucks whole-bean and ground coffee available in retail stores. Through Kraft, Starbucks has access to 3,500 Kraft salespeople, one of the largest direct-selling teams in the food industry. Starbucks sells its coffee to Kraft, which then packages and distributes it in the coffee aisle at grocery and mass-market retailers. Kraft has also provided extensive marketing for Starbucks and created several non–mass media marketing campaigns. One involved a "barista mobile" that gave out samples of Starbucks coffee.

The Quality Challenge

The late advertising executive Jay Chiat, commenting on his agency's expansion plans, once said, "I want to see how big we can grow before we get bad." That concern echoes in the minds of executives in many industries, whether they are marketing business-to-business services or consumer products. The hastening speed of communication and pace of technology transfer lead to more rapid commoditization of goods and services; in such an environment, the differentiation of a brand through customer experiences becomes ever more important — as do the relationships, internal and external, that undergird those experiences. Can businesses grow, yet still maintain the quality of those experiences?

Starbucks is certainly facing that test. Unlike many brands, it truly was built on the one-to-one relationships between its customers and employees — one cup of coffee, one customer, and one store at a time. Starbucks projects that it will ultimately have at least 10,000 to 20,000 retail locations — two to four times the number of stores it has today. In comparison, McDonald's currently has 29,000 locations around the world. Mr. Schultz and his senior executives express the wish to "grow big and yet stay small" — and they look to Starbucks's unique culture and relationships with its customers, employees, suppliers, and alliance partners as the driving force that will sustain the company as it grows.

Other companies will undoubtedly have to address the questions Starbucks is facing today. How, its executives wonder, can technology be used as a tool to make the customer service experience better while not jeopardizing the customer's relationship with the barista? How should the company maintain brand consistency in the global marketplace without becoming institutionalized? As hiring grows exponentially, how will Starbucks ensure that new partners fit in with the Starbucks culture and understand the importance of their roles within the organization? Starbucks's growth also has necessitated the need for more suppliers on a national and regional scale, and the number of its alliance partnerships continues to increase. Can they be managed toward continuing excellence, with costs remaining competitive?

Howard Schultz succinctly described the challenges that lie ahead for Starbucks: "We're opening so many stores that people are starting to feel we're approaching ubiquity," he wrote in his memoir. "If our competitive advantage has always been the relationship of trust we have with our partners, how can we maintain that as we grow from a company of 25,000 people to one of 50,000? There is no doubt in my mind that Starbucks can realize its financial goals. A more fragile issue is whether our values and guiding principles will remain intact as we continue to expand." s+b

Also contributing to this study were Suzanne Carpenter (s-carpenter2@northwestern.edu), a research fellow at the Kellogg School of Management, and David Kletter (kletter_david@bah.com), a principal with Booz Allen Hamilton.

Reprint No. 02307

Authors

Ranjay Gulati, r-gulati@nwu.edu
Ranjay Gulati is the Michael L. Nemmers Distinguished Professor of Technology and E-Commerce at the Kellogg School of Management at Northwestern University. A specialist in strategic and organizational issues in dynamic markets, Professor Gulati has published research in the *Harvard Business Review*, *Strategic Management Journal*, *Administrative Science Quarterly*, *Academy of Management Journal*, and *Sloan Management Review*.

Sarah Huffman, s-huffman@northwestern.edu
Sarah Huffman is a research fellow at the Kellogg School of Management at Northwestern University. Ms. Huffman received a Master of Science degree in integrated marketing communications from Northwestern in 2001.

Gary Neilson, neilson_gary@bah.com
Gary Neilson is a senior vice president with Booz Allen Hamilton in Chicago. He focuses on assisting Fortune 200 companies with major restructuring and the development of organizational models to increase execution effectiveness.