Case study
Starbucks – sacrificing dividends for global growth

Most companies with annual sales over $9 billion would wish to pay an annual dividend to their shareholders. But not the coffee restaurant chain Starbucks. Its purpose is to grow the company and it retained all its profits for many years to achieve this. The case explains the background and explores the implications.

Starbucks history
Originally a coffee roasting company, Starbucks opened its first coffee bar in Seattle, USA, in 1985. The young Howard Schulz, who had joined the company in 1982 as marketing executive, persuaded the original owners to use the company’s roasted beans to experiment with an ‘Italian coffee bar’ concept. The early bars were successful, so Schulz persuaded some local backers to help him buy the company in 1987. Starbucks then expanded into new cafes in Chicago and Vancouver, Canada. It was not long before there were some 17 bars. The numbers then expanded and numbered 165 at the time the company made a public offering of its shares in 1992.

Starbucks operations
Essentially, Starbucks sells fresh coffee, tea and other beverages, along with a range of snacks and light refreshments. It operates mainly in high-traffic, high-visibility locations and, in North America, it usually owns the shops. The company’s American stores dominated the total worldwide business in 2007, with just over 7,000 coffee shops (up from 4,300 in 2004). There were also another 4,000 (up from 1,800 in 2004) Starbucks in the USA that were licensed to other operators to sell Starbucks coffee products in areas where the company was not otherwise represented, such as smaller neighbourhoods, off highways and in rural locations. Starbucks’ strategy was to seek out innovative new flavours, products and even music to enhance its stores: ‘The Starbucks Experience has a rich emotional connection for people everywhere and we are creating a “third place” [in addition to home and work] for an everbroadening audience around the world.’

Internationally, the company opened its first Starbucks outside North America in 1997. By the end of 2007, there were almost 1,800 (up from 1,000 in 2004) company-owned stores and another 2,800 (up from 1,500 in 2004) licensed stores in over 40 countries. For example, there were 748 stores in Japan, 591 in China, 231 in South Korea and 50 in Singapore; there were over 614 stores in the UK, 113 in Germany but only 41 in France; there were also substantial licensing operations in the Middle East and South America but none in Africa. The company was continuing to expand rapidly and estimated that it was serving 40 million customers every week. The company commented in 2004: ‘Given our sustained success to date, we believe that we previously underestimated the scope of the long-term opportunity for Starbucks. Accordingly, we recently increased our ultimate projected growth from 25,000 to at least 30,000 stores worldwide, with at least 15,000 locations outside the United States.’ This statement with regard to purpose was arguably over-optimistic since there were still only 11,000 stores in the USA and nearly 6,000 stores internationally in 2010. Part of the reason was that Starbucks was about to hit a rough patch with regard to its sales and profitability.

Starbucks’ financial results and green strategy
The rapid increase in stores was initially reflected in similar increases in annual revenue and net profits. The company increased its sales profit margin over the years by buying centrally and by operating tightly controlled costs procedures. Conscious of its responsibility to local coffee producers and with regard to green strategy, the company ran a Farmer Support Centre in Costa Rica to support its local coffee suppliers and it also operated third-party verification procedures with regard to the social and economic practices of its many agricultural and other suppliers.

A number of the company’s senior employees were also shareholders in the company, including Howard Schulz, who was ‘chairman and chief global strategist’. Employee shareholding was part of Starbucks’ company policy since the shares were first offered for sale to the public in 1992. With such rapid growth, there was a related need to increase working capital and capital investment at the company. It was therefore not surprising that the company had never paid a dividend to its
shareholders up to 2009, though there were other methods of raising finance for such expansion. Although no share dividend was paid, shareholders clearly had the benefit of the underpinning increase in the capital value of their shares.

**Starbucks sacked its CEO in 2008**

Even though the company had performed exceptionally up to 2007, profit margins slowed after this time. The situation was considered important enough for the company’s founder, Howard Schulz, to be re-appointed in early 2008 as Chief Executive Officer (CEO) in addition to his role as Chairman. Jim Donald, the former CEO, left the company. Essentially, Schulz took the view that the company had lost its way, especially in North America. It was no longer the distinctive Starbucks experience of the past. According to an email leaked onto the web, he wrote that the coffee chain was ‘watering down’ its brand by opening too many ‘sterile, cookie cutter’ stores that lacked character and soul. The memo was headed the ‘The Commodityisation of the Starbucks Experience’ and argued that the company’s expansion from 1,000 stores to 13,000 outlets over the 10-year period to 2007 had weakened the brand. ‘We desperately need to look into the mirror and . . . make the changes necessary to evoke the heritage, the tradition and the passion that we all have for the true Starbucks experience.’ But it was not just the downgrading of the Starbucks experience that was a problem. McDonald’s Restaurants had begun a new strategy of opening coffee bars in its outlets. The competition was increasing. Starbucks’ share price dipped dramatically as a result of all this news in early 2008. This meant that, not only was the company not paying share dividends, but it was also not seeing any growth in the share price either.

**Starbucks re-invigorates its purpose**

Some analysts were even beginning to ask: how long before Starbucks changes its purpose? Starbucks’ answer was for Howard Schulz and his colleagues to re-invigorate the company. Under his guidance, the company closed down its under-performing outlets and achieved other supply-chain cost savings amounting to nearly $600 million. It refocused the company on the Starbucks Experience. More fundamentally, it decided to pay a dividend on its shares. It declared its first cash dividends per share in 2010: now that was a real change of purpose!

GREEN STRATEGY: For many years, Starbucks has had strong policies with regard to green strategy.

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**Case questions**

1. What are the benefits and dangers of focusing strongly on growth as the only purpose of an organisation?
2. Can other companies learn anything from Starbucks or is the company unique?