

## Case 5-1

### Starbucks Coffee Company

On an overcast February afternoon in 2000, Starbucks CEO Orin Smith gazed out of his office window in Seattle and contemplated what had just occurred at his company's annual shareholder meeting. In prior years, the meeting had always been a fun, all-day affair where shareholders from around the country gathered to celebrate the company's success. This year, however, Smith and other senior Starbucks executives heard an earful from the activist group Global Exchange at the meeting. Global Exchange, a human rights organization dedicated to promoting environmental, political, and social justice around the world, criticized Starbucks for profiting at the farmers' expense by paying too little for beans and not buying "fair trade" beans. Not only did the activists disrupt the company's annual meeting to the point that the convention hall security police asked the activists to leave, but they also threatened a national boycott if the company refused to sell and promote fair trade coffee. Although Smith strongly disagreed with using the shareholders meeting as a public forum, he knew there was a strong likelihood his company could face serious reprisals if it did not address the issues raised by Global Exchange.

#### FAIR TRADE COFFEE

Fair trade began after World War II as religiously affiliated non profit organizations purchased handmade products for resale from European producers. Fair trade was an economic model based on fair labor compensation and mutual respect between producers and consumers. By the late 1990s, the fair trade movement had gained a foothold in the United States, and in early 1999, TransFair USA, a third-party certification agency, launched its Fair Trade Certified coffee label. During that

summer, Global Exchange began a campaign to educate consumers and the media about labor conditions in the coffee industry, focusing on getting the message out to specialty coffee consumers. Although the activists were successful in educating pockets of consumers, they knew their effectiveness was limited without directing blame for the farmers' woes. Global Exchange decided to take an anti corporation stance and focused its attention on the most visible brand in specialty coffee: Starbucks.

At this time, fair trade coffees were coffees that were purchased directly from cooperatives of small farmers at a guaranteed floor price. Unlike shade and organic coffees, fair trade coffee focused on the workers' economic sustainability. Fair trade coffee attempted to cut out or limit the middlemen and provided much-needed credit to small farmers so that they could end their poverty cycle. Licensing organizations in individual importing countries certified fair trade coffee from farmers listed on the Fair Trade Registry. Consequently, there was a host of different certifying agencies, and fair trade coffee accounted for different market share in each country.<sup>1</sup>

#### STARBUCKS' ISSUES WITH FAIR TRADE COFFEE

For Starbucks, the real issues were brand perception and the consumer proposition. Starbucks hesitated to sign a fair trade license, not wanting to commit until it had carefully weighed all of the implications.<sup>2</sup> According to Starbucks

<sup>1</sup> Rice & McLean, p. 78.

<sup>2</sup> Smith, personal interview.

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executives, their chief concern with fair trade coffee was finding top-quality beans from cooperatives that had not demonstrated an ability to produce quality beans to Starbucks standards. From earlier cupping analyses, Starbucks had little evidence that fair trade coffee met its quality standards. Starbucks was beginning to move toward purchasing more of its coffee through direct relationships with exporters or farmers and negotiated a price based on quality. The company was willing to pay higher prices for great-quality beans and had developed long-term contracts with many of its suppliers.

Mary Williams, senior vice president (VP) of the coffee department, was known throughout the coffee industry as a "tough cupper" who would not settle for anything less than top-quality beans and explained, "the relationships I have with farmers were built over the last 20 years. It's taken some of them years before I would use their beans consistently and pay them \$US 1.26 or more. Now I was being asked to use another farmer who I didn't know and pay him the same price without the same quality standards?"<sup>3</sup> On average, farmers sent samples and met with Starbucks coffee buyers at their farms for at least 2 years before Starbucks accepted their beans. In weighing the fair trade coffee issue, Williams had secondary concerns with how the farmers she worked with would react when they discovered that other farmers received the same price without being held to the Starbucks quality standards. This was not a trivial issue because it was more expensive to grow high-quality beans. Further, she feared that the smaller cooperatives would not be able to guarantee that they could take back a low-quality shipment and replace it based on Starbucks' volume and quality needs.

Starbucks was also concerned about its brand exposure if the quality of fair trade coffee turned out to be very different from the rest of its 30 whole bean coffee line. Coffee quality was a critical component of the Starbucks brand, and if it

was compromised the value of the brand could be seriously diminished. "Honestly, we didn't want to put our brand at risk," said Tom Ehlers, VP of the Whole Bean department. "This was an uncharted category and as marketers, we were concerned about endorsing a product that didn't meet our quality standards."<sup>4</sup> The Whole Bean department would face several challenges in introducing fair trade coffee to 3,200 stores in the United States. First, it would have to come up with a good story for fair trade coffee. "A lot of our business is about the romance of coffee—where it comes from and how to make it come alive for the customer. We weren't really sure where fair trade beans would be coming from because of the quality," explained Tim Kern, Whole Bean product manager.<sup>5</sup>

And how would fair trade coffee be priced? Starbucks coffee was a high-margin business, but if the company were to charge a premium for fair trade, how would customers perceive this? Although pricing was a secondary issue to consider, it was not a reason for Starbucks to abandon fair trade coffee. Orin Smith recalled, "In fact, a number of people believed that the sale of low quality Fair Trade coffee undermined their entire business proposition with customers: Starbucks and other specialty coffee companies had persuaded customers to pay high prices for quality coffee. This enabled roasters to pay the highest prices in the industry to coffee sellers." If quality was reduced, specialty coffee would be no different than mass market coffee and the consumer would be unwilling to pay premium prices. This would destroy the industry's ability to pay price premiums to producers.

## THE STARBUCKS CULTURE

In 1990, Starbucks' senior executive team drafted a mission statement laying out the guiding principles behind the company. The

<sup>3</sup>Tom Ehlers, personal interview, Starbucks VP Whole Bean, July 25, 2002.

<sup>4</sup>Tim Kern, personal interview, Starbucks Whole Bean product manager, July 25, 2002.

<sup>3</sup>Mary Williams, Starbucks SVP Coffee Department, July 24, 2002.

**EXHIBIT 5.1 Starbucks Mission Statement**

Establish Starbucks as the premier purveyor of the finest coffee in the world while maintaining our uncompromising principles as we grow. The following six guiding principles will help us measure the appropriateness of our decisions:

- Provide a great work environment and treat each other with respect and dignity.
- Embrace diversity as an essential component in the way we do business.
- Apply the highest standards of excellence to the purchasing, roasting and fresh delivery of our coffee.
- Develop enthusiastically satisfied customers all the time.
- Contribute positively to our communities and our environment.
- Recognize that profitability is essential to our future success.

team hoped that the principles included in this mission statement would help partners (Starbucks' term for employees) to gauge the appropriateness of their decisions and actions. As Orin Smith explained, "Those guidelines are part of our culture and we try to live by them every day." After drafting the mission statement, the executive team asked all Starbucks partners to review and comment on the document. Based on their feedback, the final statement (see Exhibit 5.1), put "people first and profits last." In fact, the number one guiding principle in Starbucks' mission statement was to "provide a great work environment and treat each other with respect and dignity."

Going forward, Starbucks did three things to keep the mission and guiding principles alive. First, it provided all new partners with a copy of the mission statement and comment cards during orientation. Second, when making presentations, Starbucks' leadership continually related decisions back to the appropriate guiding principle or principles they supported. And third, the company developed a "Mission Review" system through which any partner could comment on a decision or action relative to its consistency with one of the six principles. The partner most knowledgeable on the comment had to respond directly to such a submission within two weeks, or if the comment was anonymous, the response appeared in a monthly report. As a result of this continual emphasis, the guiding principles and their underlying values had become the cornerstones of a very strong culture.

After buying Starbucks, CEO Howard Schultz had worked to develop a benefits program that would attract top people who were eager to work for the company and committed to excellence. One of Schultz's key philosophies was to "treat people like family, and they will be loyal and give their all." Accordingly, Starbucks paid more than the going wage in the restaurant and retail industries, granted stock options to both full- and part-time partners in proportion to their level of base pay, and offered health benefits for both full- and part-time partners. As a result of its commitment to its employees, Starbucks enjoyed a low annual employee turnover (60 percent versus the restaurant industry average of 200 percent) and employees reported high job satisfaction. All of this satisfaction had fostered a strong culture that employed a predominately young and educated workforce of individuals who were extremely proud to work for Starbucks. Their pride came from working for a very visible and successful company that tried to act in accordance with the values they shared. According to Smith, "It's extremely valuable to have people proud to work for Starbucks and we make decisions that are consistent with what our partners expect of us."

### **CORPORATE RESPONSIBILITY AT STARBUCKS**

Just as treating partners well was one of the pillars of Starbucks' culture, so too was contributing

positively to the communities that it served, and to the environment. Starbucks made this commitment not only because it was the right thing to do but also because its workforce was aware and concerned with global environmental and poverty issues. In addition to sustaining and growing its business, Starbucks supported causes "in both the communities where Starbucks stores were located and the countries where Starbucks coffee was grown."

On the local level, store managers were granted discretion to donate to local causes and provide coffee for local fundraisers. One Seattle store donated more than \$500,000 to Zion Preparatory Academy, an African-American school for inner-city youth. CEO Howard Schultz used his own money to start the Starbucks Foundation, which provided "opportunity grants" to nonprofit literacy groups, sponsored young writers programs, and partnered with Jumpstart, an organization helping Headstart children. Although the Starbucks Foundation was technically separate from the company, Starbucks made an annual donation to the foundation.

On the international level, in 1991, Starbucks began contributing to CARE, a worldwide relief and development foundation, as a way to give back to coffee-origin countries. By 1995, Starbucks was CARE's largest corporate donor, pledging more than \$100,000 a year and specifying that its support go to coffee-producing countries. The company's donations helped with projects such as clean-water systems, health and sanitation training, and literacy efforts. By 2001, Starbucks had contributed more than \$1.8 million to CARE.

In 1998, Starbucks partnered with Conservation International (CI), a nonprofit organization that helped promote biodiversity in coffee-growing regions, to support producers of shade-grown coffee. The coffee came from cooperatives in Chiapas, Mexico, and was introduced as a limited edition in 1999. The cooperatives' land bordered the El Triunfo Biosphere Reserve, an area designated by CI as one of the

25 "hot spots" that were home to over half of the world's known plants and animals. Since 1999, Starbucks had funded seasonal promotions of the coffee every year, with the hope of adding it to its lineup of year-round offerings. The results of the partnership had proven positive for both the environment and the Mexican farmers. Shade acreage increased by 220 percent, and farmers received a price premium of 65 percent above the market price and increased exports by 50 percent. Since the beginning of the partnership, Starbucks made loan guarantees that helped provide over \$750,000 in loans to farmers. This financial support enabled these farmers to nearly double their income.

In 1992 Starbucks developed an environmental mission statement to articulate more clearly how the company interacted with its environment, eventually creating an Environmental Affairs team tasked with developing environmentally responsible policies and minimizing the company's "footprint." Additionally, Starbucks was active in using environmental purchasing guidelines, reducing waste through recycling and energy conservation, and continually educating partners through the company's "Green Team" initiatives. In 1994, Starbucks hired Sue Mecklenburg as the first director of Environmental Affairs. Although Starbucks had supported responsible business practices virtually since its inception, as the company grew, it felt more pressure to protect its image. It was Mecklenburg who developed the idea of using paper sleeves instead of double cupping.

At the end of 1999, Starbucks created a Corporate Social Responsibility department, and Dave Olsen was named the department's first senior vice president. According to Sue Mecklenburg, "Dave really is the heart and soul of the company and is acknowledged by others as a leader. By having Dave be the first Corporate Responsibility SVP, the department had instant credibility within the company." Between 1994 and 2001, Starbucks' CSR department grew from only one person to fourteen.

## THE FAIR TRADE DECISION

Starbucks had defined being a socially responsible corporation “as conducting our business in ways that produce social, environmental and economic benefits to the communities in which we operate.” Starbucks knew that consumers were increasingly demanding more than just a “product,” at the same time that employees were increasingly electing to work for companies with strong values. In a 1999 survey by Cone Communications, 62 percent of respondents said they would switch brands or retailers to support causes they cared about. Another survey conducted in 2001 showed that 75 to 80 percent of consumers were likely to reward companies for being “good corporate citizens,” and 20 percent said they’d punish those who weren’t.<sup>6</sup> The company cared about being a responsible corporation for a variety of reasons: increasing employee satisfaction, maintaining quality supply sources, obtaining a competitive advantage through a strong reputation, and increasing shareholder value.<sup>7</sup>

As he looked out over the busy port in Seattle’s South of Downtown district, Orin

Smith pondered all of these issues. Although offering fair trade coffee was a good objective and consistent with the company’s aims of being a socially responsible organization, Smith knew he could not base his decision on this factor alone. Even though Smith had a rough idea of which issues his executive team would bring up during the discussion, as the CEO he had to consider the larger picture. He drummed his fingers on the desk and asked himself how Starbucks could support fair trade coffee given that the company had limited resources, a strong reputation to protect, and shareholders who were willing to support causes only so much.

## CASE QUESTIONS

1. What are the key issues for Starbucks?
2. What are the problems associated with the decision to offer fair trade coffee from a communication perspective? What are the problems associated with not offering fair trade coffee?
3. What should Smith do?

<sup>6</sup> Alison Maitland, “Bitter Taste of Success,” *Financial Times*, March 11, 2002, p. 2.

<sup>7</sup> Packard, “Sustainability Practices Presentation.”