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Starbucks – The Growth Trap

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Abstract

The key to achieve organizational success has been subject of much discussion throughout the years. Many theories tried to explain it, from the industrial organization model to the resource-based view. Still, there was a gap regarding how companies succeeded in dynamic markets. The dynamic capabilities view appeared in response to this breach, arguing that a firm could outperform others if it had a stronger market adaptation's ability. The present dissertation intends to illustrate this view by using a real business case, pointing out how adaptation to market changes can influence a company's performance. At a first stage, the case shows the negative impact of not being attentive to changes, and in a second period shows performance improvement by the strengthening of dynamic capabilities. When writing this thesis, I attempted to provide responses to the following questions: What dimensions can lead a strong company to fail? What factors are crucial in a turnaround? How do strategic decisions translate into changes in the resource base? The main findings of the case suggest that the dimensions that form dynamic capabilities are crucial to explain both failure and rebound, depending on the extent by which a given firm exhibits such dimensions in each relevant period. These dimensions can be interrelated, meaning that the lack of one, can affect another. In addition, it shows that dynamic capabilities are not a dichotomous issue (i.e., it is not a matter of having or not, it is rather a question of degree). Furthermore, while having dynamic capabilities can help a company to achieve success, the case suggests that, to achieve this potential, all dimensions included in the dynamic capabilities concept are important.

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I. Introduction

The dynamic capabilities view appeared as an attempt to explain the success of some companies over others. This had been the object of theoretical focus for many decades, but so far there had been no satisfactory answers for dynamic environments.

One early explanation was Porter's Industrial Organization approach (1980). It put emphasis on the industry environment rather than on the company. Later on, the resource-based view came to build upon it, focusing instead on the firm's assets and capabilities as the determinants of success. However, these theories were insufficient to address organizational success in dynamic environments.

The dynamic capability view emerged from this gap (Teece, Pisano and Shuen, 1997) and it was based on the combinations of firm specific capabilities and resources when facing changing environments. One recent definition (Barreto, 2010) proposed dynamic capabilities as a potential to solve problems in a systematic way, meaning that there are other alternatives such as ad hoc problem solving or simply luck. According to this definition, dynamic capabilities are formed by four independent dimensions: propensity to sense opportunities and threats, propensity to make timely decisions, propensity to make market-oriented decisions, and propensity to change its resource base.

Considering present times, and given the global economy reality, it is quite relevant to devote our attention to the dynamic capabilities concept. The firms' exposure to multinational markets, undergoing fast and systematic changes throughout a very wide and dispersed geographical reach, creates the need for them to embrace this view (Teece, 2007). High velocity environments, by nature, are linked with a more frequent occurrence of change and the average period that a firm is able to sustain its competitive advantage is shown to be decreasing over time, which therefore leads to a need for achieving successive competitive advantages (Barreto, 2010; D'Aveni, 1994; Eisenhardt and Martin, 2000).

The fact that this concept can be helpful at a multidisciplinary level makes it even more important to pursue. The framework is able to integrate numerous research fields such as strategic management, law, economics, and innovation, among several others (Teece 2007). Many scholars have dedicated their time and energy to the development of the dynamic capabilities view and this phenomenon has been increasing over time, as it is observable by doing a simple research in the ABI/INFORM database. Not only the research has expanded, it has also been gaining credibility by being published in top management journals and been awarded well-known prizes, such as in the cases of Winter (2003); Eisenhardt and Martin (2000); Teece, Pisano and Shuen (1997), which all received The Dan and Mary Lou Schendel Best Paper Award, from the Strategic Management Society in recent years.

How to respond efficiently and effectively to change has always been a constant question (D'Aveni, 1994; Eisenhardt and Martin, 2000). A company that went through a recent search for this answer was Starbucks. This firm is a US-based specialty coffee retailer that had been thriving in its industry for 40 years now, being the undisputed market leader. It is present in the Most Admired Companies list, as well as in the Fortune 500 since 2003.

Around 2006, Starbucks' performance started decreasing. What issues led such a strong company to fail? What factors were crucial to the subsequent turnaround? How did strategic decisions translate into changes in the resource base?

This paper aims to focus on the dimensions underlying the dynamic capabilities' concept, and apply them to the Starbucks case. The present dissertation will try to answer the above-mentioned questions in five main sections. There will be a literature review in order to summarize the main findings in the dynamic capabilities field. In the second section, I will present the teaching case of Starbucks. In the subsequent section, I present the teaching note relative to the case. Afterwards, I include a Discussion section, highlighting the main contributions and limitations, and finally the conclusion, summarising the findings.

This dissertation will hopefully allow a better understanding of the role of the dynamic capabilities view and its dimensions on a very strong company, such as Starbucks. It intends to prove the practical relevance of that view for companies who struggle with success when facing a changing market.

II. Literature Review

The dynamic capabilities view has been evolving since its first appearance (Teece, Pisano and Shuen, 1997), having captured much attention since then, which has eventually led to some dispersion in the field. In consequence, there was a need for conceptualization integrating the key elements of this dispersed, past research, enabling the evolution of the field.

Taking a step back in time, it is very important to understand the origins of this concept. The dynamic capabilities' view is the most recent attempt to explain the success of a firm over others, but there had been other attempts before. Michael Porter (1980) tried to solve this mystery with his industrial organisation model, stating that the company performance would depend mostly on the sector. It was a breakthrough in management and still today this theory is widely used to evaluate a company's environment.

The resource-based view (RBV) appeared to overcome the industry focused perspective, by introducing the importance of firm's core competences. It put emphasis on the internal factors as determinants of success, rather than on the external setting. However, it is a static approach, overlooking changing environments (Priem and Butler, 2001).

The dynamic capabilities view was developed considering dynamic markets and its impact on organizational success. In its founding work, dynamic capability was described as an "ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments" (Teece, Pisano and Shuen, 1997). This definition had significant limitations, given that it was somehow tautological. Nevertheless, it addressed the search for an outstanding performance in a dynamic market, opening the door to this unexplored field.

Later, one paper expressed dynamic capabilities as "processes that use resources" (Eisenhardt and Martin, 2000), and also considered that the market would have an influence on the configuration of those resources. Zollo and Winter (2002) suggested dynamic capabilities as routines; they defined dynamic capabilities as a "learned and stable pattern of collective activity". Adding to this, they felt the need to add a purpose - "improved effectiveness". Later on, Winter (2003) divided capabilities in two levels. The higher order capabilities would influence the ordinary ones, which in turn allowed short-term survival. The resource base notion appeared with Helfat *et al*. work (2007), where the organization's capacity of adaptation to a change in the market involved also adjusting the resource base. Another relevant innovation to the dynamic capabilities view emerged with Teece (2007), when he expressed it as being a compound of elements. Nonetheless, so far, it was not possible to test the validity of any definition, and therefore they were seen as tautological (Williamson, 1999) and vague (Kraatz and Zajac, 2001).

Barreto (2010) was the author who was able to put forward a definition condensing the previous research, reaching a solid definition and providing guidelines for the future. This latest view defined dynamic capabilities as a multidimensional construct of four variables, which allowed testing. The dimensions, "propensity to sense opportunities and threats, to make timely and market-oriented decisions, and to change its resource base", are not necessarily related, making it important to look at the variance and covariance that are both common for the construct and specific for each of them. These dimensions emerged as a consolidation of what had been mentioned by other authors in the past. The propensity to sense opportunities and threats was present in Teece's work (2007) under the terms "capacity to sense and shape opportunities and threats" and it also refers to the monitoring of the capabilities (Schreyögg and Kliesch-Eberl, 2007). The knowledge a company acquires over time, which consequently leads to the formation of routines, can be determinant when facing an exogenous shock.

Making timely decisions had already been mentioned briefly by Eisenhardt and Martin (2002), under the concept of doing it "sooner". Anticipation can provide a firm with the first mover advantage, which usually translates into a stronger position regarding competition.

Concerning the market oriented aspect, it was highlighted by Adner and Helfat (2003), when they referred that the "content" of a decision was also crucial. Adapting to market trends and needs, and therefore offering high value to customers is decisive for a firm to be competitive. "Using real time information, cross functional relationships and intensive communication" (Eisenhardt and Marting, 2000), provided by effective routines, is important towards making wise decisions.

The last element of the definition, the change in the "resource base", was introduced by Helfat *et al.* (2007) and revived by Barreto (2010). It is crucial, not only to make the right decisions, at the right moment, but also to reconfigure resources according to those strategic choices.

This dynamic capabilities definition was presented as a "potential to systematically solve problems", which tells the reader it is not the only answer or even the right one, it is one option among others, such as "ad-hoc problem solving" (Winter, 2003) and "luck" (Barney, 1986). Furthermore, "potential" avoids a dichotomous judgement, dynamic capabilities are not a black and white definition, it can be used at different levels, which is somewhat in line with what Winter (2003) stated.

In addition, by being a possible way of solving a problem, it implies the need to be exercised at a given moment, it is a choice. Moreover, it suggests a persistent character, since to achieve a systematic approach, it needs to be trained and consistently evoked. It's not automated, but rather a learned pattern.

The heterogeneity has been a much discussed topic within the dynamic capabilities scope. In the first work ever published on the topic (Teece *et al*., 1997) the assumption was that each firm had its unique set of dynamic capabilities. It was a natural derivative from the existing VRIN criteria, part of the RBV theory. According to it, resources that provide sustainable competitive advantage would need to be valuable, rare, inimitable and nonsubstitutable. However it was not always the case of dynamic capabilities, at least not for Eisenhardt and Martin (2000), who supported that best practices were widely adopted by businesses in order to improve performance. Nonetheless the paper suggested that some details of each company were idiosyncratic, which meant that, as a whole, each firm was unique. Barreto (2010) came to support this view, there can be commonalities in some of the dimensions, while others are differentiated, and therefore dynamic capabilities are singular in details.

The dynamic capabilities' effect on a firm's performance has also been an area of divergence, having three different paths been proposed through time. The first was a direct link between dynamic capabilities and performance, which was presented in the primordial paper (Teece *et al.*, 1997), but it did not hold due to the phrasing of the definition. This article defined a capability as an "ability", this way not clarifying the concept, just stating it in a slightly different form. In the second proposal, dynamic capabilities were not necessarily linked with success, it would depend on the resulting resource base and management decisions. The conclusion was that these capabilities were necessary, but not sufficient to succeed (Eisenhardt and Martin, 2000; Helfat *et al.,* 2007). Nonetheless, dynamic capabilities may not be the solution for all the problems that emerge in a firm, as Winter (2003) stated, sometimes it might be too costly to implement a system that enabled the creation of such capabilities, alternatively suggesting ad-hoc problem solving. The last approach connected dynamic capabilities to performance through an indirect link (Zott, 2003). It was not yet clear how this relationship was defined, but future research on the field was alerted not to propose an association over these two factors, since the definition of dynamic capabilities tried to analyze that relation trough the dimensions' study (Barreto, 2010).

To understand when dynamic capabilities are profitable to implement, there are two factors that must be carefully examined: the industry and the size of the company. Since the origin of the view, dynamic capabilities seemed to be more useful in high velocity markets (Eisenhardt and Martin, 2000), since in these cases the need for an efficient adaptation was much greater. In addition, the capabilities need to be flexible, creating grounds for a better and faster reaction to changes, this way adding more value. On the other hand, Zahra, Sapienza, and Davidsson (2006) defended that dynamic capabilities would also be useful in stable and more predictable environments, relying on knowledge the company has acquired through time, which led to the creation of routines. Barreto (2010) presented in his paper that there is still a long road ahead, more research should be done regarding the competitive environment where dynamic capabilities would add more value.
The relevance of the firm's size is not well defined yet, some authors have stated that it was more beneficial for larger, multinational companies to own dynamic capabilities (Zollo and Winter, 2002) due to the advantage of scale on the implementing of learning mechanisms; other authirs suggested any company would gain by adopting this view (Døving and Gooderham, 2008). There is still the need to deepen the analysis and find a consensus regarding this variable.

Going back to the quest for a firm's key to success, it's essential to understand how dynamic capabilities can contribute to it. As we live in a changing environment rather than in a static one, adaptation is vital. The idea of maintaining a sustainable competitive advantage indefinitely is not very realistic. The goal is then to achieve successive competitive advantages, facing the various changes in the markets, which can be leveraged on the existence of dynamic capabilities (D'aveni, 1994, Eisenhardt and Martin, 2000). However, there is no guarantee that there will be a positive return from implementing dynamic capabilities. It will depend on other variables such as how the resource base will turn out or management decisions. Managers don't always understand the benefits, it is not clear for them that the advantages can overcome the investment. It requires a long-term commitment to put in place such a view, but in the end it is expectable that "on average, firms with higher levels of dynamic capabilities present higher levels of performance" (Barreto, 2010).

III. Teaching Case

Starbucks – The Growth Trap

When Starbucks opened its doors in 1971 in Seattle as a local and humble coffee shop, no one could imagine the growth this organization would have. Howard D. Schultz was the one who, back in 1987, bought Starbucks with a dream: he wanted to bring quality coffee into the American market. Since then, Starbucks went from a small chain of 6 stores into a giant owning 17,000 shops.

Starbucks made a difference through its unique identity, focusing its energies on providing a distinctive coffee tasting experience. In 2000, Schultz stepped out of his CEO position, leaving its successful 3,501 stores company in Orin C. Smith's hands and later in Jim Donald's. Eight years later, Starbucks was failing, and Schultz was forced to return to put the organization back on track. Stock price had dropped from $39 in November 2006 to $19 in 2008.

By 2011, after numerous changes, Starbucks was back on its feet, and a proud, yet humble Schultz was reminded of "how fleeting success and wining can be"[1]. What had happened along the way? Why wasn't Starbucks able to maintain its performance? How did Schultz's decisions help Starbucks?

Starbucks unknown early years

The name that first comes to our minds when speaking of Starbucks is the one from of current CEO, Howard D. Schultz. However Starbucks' was founded in Seattle by Jerry Baldwin, Zev Ziegler and Gordon Bowker in 1971 to offer what coffee lovers wanted: drink high quality coffee[2].

Howard D. Schultz, living in America at the time, had quite a normal life as a modest Jewish New Yorker. After getting his degree at the Northern Michigan University in 1975, and working through several jobs, he became general manager of a coffee maker manufacturer, Hammarplast. In 1981, as a part of his job, he went to Seattle to a visit a local store that had been buying its coffee makers in higher quantities than the other clients, and in 1982 he ended up joining that coffee shop - Starbucks.

On a business trip to Milan, Italy, he found a very different coffee market, where there were small stores in every corner, the coffee had high quality and they were seen as social hubs[3]. In that moment he had a vision: to bring that European concept to the American market. He then returned to Seattle with his mind set-up to acquire Starbucks and take his new concept to North America. This was 1987, the American coffee culture was very undeveloped, from the 1960s to mid 1980s coffee sales had been declining, but premium coffee demand was increasing[4]. At the time he had to pay $3.8 million for the acquisition of the six retail stores and a roasting plant.

The new CEO's vision was to create a "third place"[5], providing high quality, customized coffee drinks, through a team of specialized baristas, who maintained a personal relationship with customers. Knowing clients by name and anticipating the order was the ultimate goal for the employees[6]. It was all about the experience and culture, and that made them into a premium coffee brand that people were willing to pay for. Schultz focused much on the community factor, he stated, "I tried to build a company my father would have been proud to work for, that he would have looked back on and said, 'That's the company that honoured me, even though I don't have an education'. I wanted to build a company that had a conscience", and it was more than just words, he brought it to life. It eventually became a culture that was unique to this company.

All aspects of the supply chain were tightly controlled. Schultz made sure that his high quality standards were guaranteed right from the coffee beans suppliers to the person serving the coffee. "It is how we buy coffee that makes Starbucks special" said Dub Hay, one of the company executives, denoting how important the beans' quality was. Employees, also known as "partners", were respected and rewarded highly above the market. They had privileges such as healthcare and stock options, creating a situation where the success of the company impacted directly on their wealth. For Schultz, hiring and training the best people was "the best way to meet and exceed the expectations of customers"[7].

Starbucks was committed to be a responsible corporate citizen, showing concern about customers, employees and the coffee growing community. For Starbucks, the overall goal was to be seen as a "company that cares"[8].

The retailer devoted a special attention to consumer preferences. Baristas were always on the watch for client's repeated requests or behind-the-counter preparation. Many of the new offerings came to life through this process. Furthermore, in order to ensure a consistency of the drinks' taste, there were standardized procedures that employees had to strictly follow.

The value proposition Starbucks brought to the coffee market was a combination of quality products, enhanced customer service and a distinctive atmosphere[9]. Ultimately, Starbucks came to change the coffee culture, transform the way coffee was drank, raise the willingness to pay, and become the company Americans thought of when talking about coffee[10]. Customers were actually willing to pay as much as $3.50 for a single drink - a blast of premium coffee[11].

Becoming a giant

America was the place where the modern chain store was created with the Great Atlantic & Pacific Tea Company's opening in 1859. There was a major adoption of the concept, and by the early 1950s chains accounted already for 23% of the total retail volume. When Starbucks entered in the specialty coffee market, big chains were still flourishing.

Howard Schultz decided to enter into this market in 1987, and for that, the first step he took towards expansion was to surround himself with people who had the right expertise. Howard Behar, the President of Thousand Trails Inc, an outdoor resorts developer, was hired in 1989 and being a retail veteran he was the one who put emphasis on consumer service[12]. The CEO also searched for other executives who had experience in the food industry, to aid him building a strategy that would allow the growth he wanted[13].

Starbucks enjoyed a favourable consumer trend towards specialty food, supported by the increasing income per capita and by some popular TV shows (for instance "Friends" launched a tendency of hanging-out in coffee shops). The market was developing very rapidly, from 585 coffee retailers in 1989, the number increased to 12,000 in 1999[14].

During the early presence of Howard Schultz as CEO, the company grew from the six Seattle based stores to 3,501, mainly concentrated in North America, but also with presence in 18 other geographies (Exhibit 1 and Exhibit 2) in 2000. The Asia-Pacific region was one of the targets due to its massive concentration of population and there was also some interest in Europe, as revealed by the entrance in the U.K., the safest doorway due to country similarities.

The strategy used to expand in North America was to create clusters, which translated into opening stores so close to each other that no other competitor would dare to enter. This method of penetration would lead to cannibalization between shops, but it seemed to be worth it[15]. Schulz also established many alliances, which enabled him to reach more locations, namely airports, retail stores and supermarkets, and increase the variety of products Starbucks was offering, such as the Frappuccino.

Starbucks evolution until 2000 was a success, its stock price raised to $44.25, comparing to its 1992's IPO price of $17 a share. People adhered to the concept and it became part of their routine. Starbucks was not only selling coffee, but a whole set of experiences. Apparently Starbucks was successful in delivering value to customers, as the average customer visited Starbucks' locations 18 times a month and spent $3.50 each time[16], making it the most visited retailer in the country[17]. By this time, the net revenue was $2.2 billion, enabling a 9.7% operating margin (Exhibit 3). Meanwhile, Schultz stepped out of his role to become chairman and chief strategist.

From 2001 to 2005, now under the command of Orin Smith, a Starbucks manager since 1990, the firm achieved a revenue of $6.4 billion, after opening additional 6,740 stores, which led to a total of 10,241 locations (Exhibit 4). During Smith's mandate, new features were added to Starbucks in order to create newness, enhancing the atmosphere and providing a better experience to customers. The most significant introduction was the prepaid card, in November 2001, which allowed Starbucks to spot its best clients, while simplifying transactions and attracting new customers[18]. Surveys were pointing to the conclusion that having the card would lead clientele to come to Starbucks twice as much as non-cardholders. The company also made an important acquisition in 2003, Seattle's Best Coffee, which was a significant premium competitor. According to Howard Schultz, the Chairman at that time, the new asset provided an opportunity to launch the next phase of their specialty coffee growth.

The coffee market was expanding, having experienced a 157% growth between 2000 ($3,258m) and 2005 ($8,372m), with premium coffee gaining a special relevance, but still independent shops were gaining market, 5% a year[19]. It was a very attractive business to be in, as Joe Pawlak, a consultant from Technomic said in the USA Today "Depending on how you price it, you can make 90% margins-plus."[20]. The number of shops increased much - for instance, in one intersection in Seattle, Starbucks had stores in three of the four corners and was considering opening another on the fourth[21]. This company held such a strong position that even after the American tragedy of September 11th, Schultz was comfortable enough to say, "I think we've demonstrated that we are close to a recession-proof product".

Jim Donald was the next in line to step up as CEO and stayed from 2005, a time when the stock was at $61.14 at the beginning of the year, until 2007 when shares were transacted at $20. He had quite a reputation for successful turnarounds along his career. An example of it was his presence in the Wal-Mart stores, where he expanded 6 locations into 146. His goal for Starbucks was to turn it into a 40,000 store chain worldwide and he took measures in order to achieve it. The company reached a six stores per day opening rate in 2006, having as strategy: increasing convenience.

At this point some analysts doubted the sustainability of the company growth approach. Later in 2006 store sales started declining as well as stock price, which was $35.42 by the end of 2006. Still, by the time Donald left Starbucks, it had a revenue of $9,4 billion with 14,895 stores (Exhibit 5).

Tendencies had changed regarding the attachment to big multinational chains. Although worldwide 76% of the population preferred multinational chains, once they expanded the consumer choices, people were becoming aware of its negative impacts on the local culture. Regarding the US population, only 14% stated that big chains were better than small coffee houses[22] (Exhibit 6).

In 2005 there were already some indicators showing consumers were starting to become more interested in the local communities instead of global brands[23]. There was a trend towards buying locally, as confirmed by a study performed by Civic Economics, stating that locally owned businesses put approximately twice the money into the community than a chain retailer does[24]. Also, a crisis, like the subprime mortgage crisis in America, led people to reconsider their values, giving more emphasis to what is "real" - friends, neighbours, family and their community – therefore fleeting the global giants toward a more familiar solution[25]. For the first time there was a counter-trend to globalization and it was embedding America and starting to spread. Coffee consumers and even some cartoons were diminishing Starbucks image, proffering opinions such as:

"I feel, especially in Chicago, our theory was the reason we weren't able to find a really good coffee shop there is because a Starbucks is on almost every corner. Starbucks is awful. There is even a Simpsons episode where Bart Simpson walks into the mall, and then you see a Starbucks and you see next door, "Coming Soon—Starbucks." Then he leaves and you see the whole mall from the inside, and it's wall-to-wall Starbucks. It's funny, but in a way it's true."[26]

Furthermore, drinking coffee in an inviting atmosphere was not appreciated as highly as expected, since only 14% of the American respondents thought it was a valuable feature, comparing to the 44% of the world average[27].

Trends in 2007 were anticipating issues in big chains, such as the one stated by The Trend Journal: "Major chains, from sporting goods to cups of coffee, whose business models are based on growing stores rather than increasing in-store sales, will decline in share value"[28].

Regarding the willingness to pay, 73% of the Americans thought that Starbucks coffee was overpriced in 2008. Only 6% of the respondents were defending that this retailer was providing good value for money[29], especially considering that everyday's rush made people grab their coffee in a quick in and out visit to the store. There was less value in offering an experience that customers didn't had the time to enjoy[30]. Most of the sales in the Starbucks American stores were takeaway. However, convenience was an important driver of purchase and in that factor, Starbucks excelled. This driver accounted for 64.6% of the choice of where to drink coffee.

Yet another change occurred in the American market: younger people were becoming more addicted to coffee. By 2008, the fourth year in a row increase, people among 18 to 24 years old were consuming more coffee, about 6% in that year alone[31]. This meant more people at those ages looking for fancy drinks and willing to pay for it. As Bruce Milletto, president of Bellissimo Coffee InfoGroup, stated in an interview "consumers are becoming more particular", their reasoning is "We want good coffee and we're willing to pay for it"[32]. On the other hand, older people, who were the bigger parcel of the population, preferred to drink a plain, black coffee (Exhibit 7).

Economy downturn

The American market suffered a huge slowdown with the subprime mortgage crisis and this economical downturn achieved its high in 2008[33]. By this time, Americans were very restricted regarding their discretionary budget, and very pessimistic also. Spending money in specialty goods was not a viable possibility, the essential expenditures were the priority and therefore all premium retailers saw their business threatened. In addition, gas prices also rose as well as some other basic goods, "pinching" consumers even more[34].

Starbucks was also affected by the economical decline, especially given that there were low cost chains betting on the coffee shop sector. McDonalds had just launched McCafés with success. Consumers were choosing McDonald's espresso as better tasting over some premium brands, including Starbucks[35]. To make matters worse, these low cost coffee bars were planned to be implemented in 14,000 of the American McDonald's stores, creating a new alternative for budget restricted consumers with a massive country reach (Exhibit 8). This low end retailer was pushing a change in consumer minds and consequently the coffee connotation was taking a step back, into a commodity again. Starbucks had managed to establish coffee as an experience and was now losing its edge[36]. Schultz, the chairman at the moment, admitted to have misread the economy, he confessed the company had underestimated the effect that the recession would have on consumer spending[37].

Adding to the above mentioned issues, Starbucks was no longer alone in the quality coffee business, as it was facing direct competition such as Caribou Coffee, Peet's Coffee and Tea, Panera Bread, Dunkin' Donuts, the Coffee Bean and Tea Leaf among others. All of them offered quality coffee, and even though their strategies differed (Exhibit 9), all of them were playing strong cards.

Despite the fact that there was a difficult economic landscape, this did not seem to be the major cause for the firm's issues. Starbucks was already decreasing its performance in 2006, two years before the Nasdaq index - market where the actions are transacted - and its comparable industry (Exhibit 10), and before the American population felt the budget restriction (Exhibit 11). Moreover, according to the American National Coffee Association, specialty coffee demand was rising. Consumers had not stopped drinking specialty coffee. "People seem like they still need their coffee", said the Euromonitor researcher Ty Law, they were just pickier on making choices. The reasoning for purchase seemed to be supported by the total value proposition offered by the brand, analysing quality, variety, convenience and price[38].

The Globe

The landscape around the globe differed much from the American reality. The hot drinks market had a huge potential. In 2007 the world market value was estimated to be $58.6 billion, 54.7% of which was generated by coffee, and with a forecast to achieve $66.3 billion by 2012[39]. American brands were thriving, big chains were appreciated at a much higher rate, the features valued differed from the American reality, the brands were viewed differently, and the preferences also diverged.

Coffee had become an addiction throughout the world. In many locations, people simply couldn't live without at least one coffee in the morning, which was the case of the majority of the Serbians, French, and Americans among others (Exhibit 12).

Starbucks meant different things according to the place it was on[40]. To the Asian market, Starbucks was regarded as a social place for businessmen and several other consumers to meet and the transactions were mainly for indoor consumption. It was enjoying huge success, with Japan alone having a market value of $7,801 million in the ready to drink (RTD) market and a 74,5% share in global RTD market in 2008[41] (Exhibit 13). Still, Asia consumers were the least caffeine-lovers (Exhibit 14), with tea having an enormous relevance[42], and accounting for 38.1% of the global hot drinks' market in 2007[43].

One big issue on international operations was the arrival of many copycats. Similar designs, name and logo were used all over the world in an attempt to build profitable local businesses. Starbucks was fighting to overcome this obstacle, and, in some cases, it even had to file suits, such as in China, against Shanghai Xingbake Café (Exhibit 15).

Furthermore, Starbucks, as many other big chains, had to struggle with international local opinions[44]. There were several judgments against such a huge brand, with activists ranging from farmers' supporters, nutritionists, to anti US brands.

Behind the Expansion

The growth happened not only because the company was pushing it, but perhaps also due to a strong pressure from investors. Being a public organization since 1992, the financial performance was always under the attentive eyes of Wall Street, as Schultz mentioned in one of his interviews[45]. The company was evaluated on continued expansion, meaning that the attention was focused on how many stores opened each year and how the sales per stores evolved. In order to keep up with such a pressure, changes occurred in the company, some more visible than others.

The amount of stores Starbucks owned in North America, together with the International growth, led to an overexpansion in a mature market[46]. Starbucks wasn't capable of delivering the same quality service people were expecting. Baristas just needed to press the coffee-maker button and immediately they had a "soulless coffee"[47]. Furthermore, the coffee tasted burned, turning Starbucks into "Charbucks"[48] as some dissatisfied customers called it. There was no longer the personal relationship with baristas, since the goal was to take the minimum time possible to serve a customer, so that the waiting line was small, and the frequency of transactions higher. Coffee machines were automated also to improve efficiency, and became much bigger in size, not allowing baristas to make eye contact with the client while preparing the beverage. There was also a standardization of the store design, as cited in the 2007 Memo from Howard Schultz: "stores no longer have the soul of the past and reflect a chain of stores vs. the warm feeling of a neighbourhood store". Even the most basic details were missing (e.g. cups where leaking)[49]. Starbucks was no longer unique and providing a cosy "third place" with high quality coffee.

The firm's focus on coffee seemed to have disappeared given the wide dispersion of products, and many of them were not even coffee-related (CDs, DVDs, books or teddy bears); other products jeopardized the aroma that characterized the stores[50]. For instance, between 2005 and 2006, there were 22 new beverages, the food menu contained a wide range of items from breakfast to desserts and the entertainment department was evolving with a plan to partner with iTunes providing a Starbucks area on Apple's application. The retailer justified the massive offer as an improvement to the experience provided, but it seemed more as a way to achieve a higher check per customer.

The brand was also expanding to new distribution channels. At the time, Starbucks' products could be found in groceries or retail outlets. They thought it was a mean to achieve more visibility.

The international markets became more and more a company concern, it had proven to be a source of strong profitability (Exhibit 16), accounting for almost 30% of Starbucks 2008 revenues. The entry strategy was tailored to match the conditions of the target location; they chose whether to enter through organic growth, joint venture, acquisitions or licensing. There was always some degree of local adaptation according to tastes and habits in order to get a balance between customization and consistency. For instance, China had a very different culture where people prefer tea. Drinking coffee was a social event and Starbucks needed to take this in account when implementing its operations (Exhibit 17). Also, Chinese people never drank their coffee without food, leading the company to increase the food offer. Overall, the drivers of a successful market penetration were the right choice of partnerships (Exhibit 18), the premium image and effort on meeting key consumer preferences[51]. Independently of the entry mode chosen, Starbucks desire was always to gain control over the stores. The goal seemed to be entering in as many locations as possible, and in the fastest way. Efforts were mainly focused on few countries with high potential, namely Brazil, India, China and Russia[52].

However, somewhere along the road Starbucks had lost its identity and even the founder of the concept was appealing for a return "to the core" (Exhibit 19). During the search for a strong growth, the company lost sight of what was really important, ultimately hurting their very own foundation. Growth became an addiction, but as Howard Schultz said "growth should not be – and is not - a strategy; it's a tactic"[53].

Back to core

The Organization

By 2008, in response to the decreasing performance, Howard Schultz returned "home", to his former CEO position. At his arrival the shares were transacted at $19.31. He was fully energized and aware of what had happened to Starbucks along the way, bringing with him a handful of improvement suggestions. As he said, “we lost our way”, adjustments needed to be made, “we went back to start-up mode, hand-to-hand combat every day”.

Taking a step back

The chief executive officer had a strategy to pursue and it involved many adaptations, starting at cutting in the number of stores. Everything was put into question, as Starbucks needed to identify what had gone wrong.

The first realization was that the massive growth they had been undertaking had become “carcinogen”. Schultz needed to cut costs, reorganize the company and rebuild the strategy, as he wanted to do “the right thing”[54].

The underperforming stores were closed and, interestingly, some of them had just opened. As Schultz said in an interview with McKinsey, the investment decisions “were made with a lack of discipline”, they were “kind of complicit with the stock price”. In order to avoid these poor assessments, the company stopped reporting the same-store sales, the business focus would, from this point on, be only on the customer. About 900 stores had closed across the globe by early 2009, employees were laid off and ultimately costs were cut by $580 million[55]. These were harsh times, cutting was the word of the day, and it was not the best image to pass to a community, but it had to be done in order to revive the company. The diversity of products was also revised, there was a re-focus on coffee and on what Schultz liked to call the “romance” around it. The company ''is committed to examining all aspects of our business that are not directly related to our core'', said the CEO.

The team

Schultz immediately reorganized the executives that surrounded him, and only two of the top 10 executives remained in the company. Some key executives had stepped out recently. For instance, Michael Casey, the CFO resigned his position in 2007, although remaining a firm’s advisor. He gave place to Peter Bocian who was seen as an added value due to, as stated by Jim Donald, “his international finance experience and proven leadership skills as we continue our aggressive expansion overseas”.

Cliff Burrows became the new president, after having occupied varied management positions with Habitat Designs Limited, a furniture and house wares retailer. He was hired to dedicate his time to customers’ preferences, according to the location, as he said “it's about consumers influenced by where they live''.

The Chief Information Officer, Bryan Crynes, was let go by Schultz. He had been in that position since 2001, and allegedly there was too much bureaucracy getting in the way of an effective IT system dedicated to the customer experience[56]. Chris Bruzzo, the former Vice President of Digital Strategy and the recently appointed Chief Technology Officer filled this place. His functions included rethinking ways to connect with customers with the use of technology, such as loyalty initiatives.

Arthur Rubinfield was one of the new acquisitions Schultz brought in, he was part of Starbucks until 2002, and had been crucial for brand development. At this point he entered as the President of Global Development, putting his efforts to the local adaptation.

Not just executives were contemplated in Howard Schultz’s plan. Baristas also played a big role. In order to accomplish a so-called community, where employees knew customers by name, it was very important that they were skilled, the staff turnover rate was low, and the partners were satisfied.

The first step was to get feedback, in order to improve employee’s satisfaction, and therefore decrease staff turnover. They were the face of the company, thus it was important they communicated the right message. There was an effort on education and training. This investment provided partners with knowledge, not only about the coffee history and espresso making, but also about how to deal with clients. As Howard announced though a videotaped message, “This is about the love and compassion and commitment that we all need to have for the customer”. The barista needed to be an artist in making coffee and also a person with good interpersonal skills[57]. The partners were also asked to discuss ideas to improve techniques, aiming to enhance the taste and texture of drinks, since they were the ones dealing both with customers and the coffee. Ultimately it was a quest for employee engagement.

Understanding the market

Howard Schultz quickly understood that he had to get insights about the market, find out who were the ones buying from him and what they searched for. Upon his arrival Starbucks performed customer research surveys and created a social network. The whole point was to get as much suggestions and feedback as possible in order to offer greater value to the right customers. The online community, mystarbucksidea.com, was intended to become an interactive forum connecting customers, partners and other stakeholders. It encouraged everyone to give opinions, and to comment other's contributions, the most relevant ideas were revised to possible implementation and went to a separate blog "Ideas in Action". Eventually some of the proposals even became part of Starbucks processes. An example of this was the elimination of receipts, when transactions were of very low value, which allowed reducing paper waste[58].

Another big step was the adaption of the retailer to the location it was inserted in. This adjustment included dimensions from the architectural and decoration sections, to the actual products offered. The inside store environment should reflect the local culture, using local art and furniture. It should also be adapted to the public that visited a given store. For instance, if the main customers were students and stayed in the store to study, there should be space dedicated to it. If the store had mainly takeaway customers, then the disposition should be quite different. The most extreme situation was the opening of a shop in Seattle, Starbucks' birthplace, but under a different name: the shop was called "15th Ave. Coffee & Tea". It was an attempt to create a deeper connection with the local community, showing how the company understood the importance of moving away from standardization.

The offer in each place should be in line with the local preferences. For example, serving more cold drinks in Sun Belt, while Pacific Northwest preferred espresso, and Asia appreciated its tea. The beans would also match the tastes, adopting a more artisanal shop approach.

The Prepaid Cards that had been introduced in 2001 were, in 2008, supplied with a new function, a reward program. By doing so, clients were able to customize their drinks for free. It was a clear incentive to build a deeper relation and even attract more heavy users.

Increasing Visibility

Starbucks decided to bet on heavier advertisement, leaving behind the conservative method of only approaching a small target with a big impact. It's not that they didn't want to devote attention to word-of-mouth incitation events, but it was no longer their sole line of attack. They chose to promote this somewhat mainstream side to compete with the new entrant McDonalds, and so did other players in the market (Exhibit 20). The means used were TV campaigns or coupons in newspapers. It was a very high investment, about $100 million in 2008, but it was a strong method to increase visibility[59].

Moreover, Starbucks planned to better communicate its social initiatives, and even intensify them. It was a way of diminishing criticisms by worldwide activists, and to reflect the effort put in the communities.

Distribution channels were enlarged, in order to reach more people. As the CEO mentioned when giving an interview, he wanted to create a new advantage, the idea was to "build complementary channels of distribution by integrating the retail footprint and the ubiquitous channels of distribution – in our case, grocery stores and drug stores". Not forgetting that more than 11% of the Americans bought flavoured coffee to consume at home, it was not a market that Starbucks wanted to miss out[60]. The retailer was seeking to push more own brand products, through a wide variety of cannels, considering also selling through hotels or restaurants[61], to expand the offer of products and experiences to another level. All in all, consumers would encounter Starbucks spread throughout their day-to-day life.

Serving Customers

Starbucks was in a big quest to regain its vitality. To do that, one of the most determinant decisions was about what customers to attack and how. Howard Schultz chose a peculiar path: to remain a premium brand, reviving it, while serving also the price-sensitive segment[62].

To recuperate the premium connotation Starbucks once had, the company needed to focus on the coffee, and the experience provided. Coffee had always been at the core of Starbucks success. It presented a quality that America hadn't experienced until the company's appearance, and it was what differentiated the retailer.

The first measure towards the reinforcement of quality coffee was the adoption of a new espresso machine, Mastrena, instead of the present automatic one. It was smaller, allowing customers to see the barista and interact with him while making the drink; by being manually operated it allowed employees to practice their coffee-making technique, and finally it grinded coffee for each drink. The speed was not compromised, since the new machine could still guarantee the so required efficiency.

The following big move was the acquisition of the Coffee Equipment Company in March 2008, granting them the access to a machine with the capability of brewing one cup at a time, instead of a pot. The name of the high-end coffee maker was Clover and it allowed making a more expensive, yet higher quality drink. It enabled controlling the temperature, the amount of water and brewing period through a number of programmes adapted to each type of bean, and still not taking too much time. It took less than two minutes to get a really good coffee, while the comparable French drink took around ten minutes[63]. The acquirement was an incentive for media to dedicate more attention to Starbucks, the machines were being acclaimed: "now you can get perfect extraction"[64] published in The New York Times; "ingenious" and "the coffee is so good people have no problem paying $6 for a cup"[65] was stated in The Economist.

The coffee itself was also a point of improvement. The CEO proposed a new blend containing beans that, in his words, were "so fresh that [people who drink coffee with milk and sugar] will want to drink it black". The mix was named Pike Place, and its overall purpose was to provide a great coffee, with assured freshness and quality.

The prices of specialty drinks increased, not only as a signal of the premium brand that Starbucks was, but also as a response to the overall rise in the costs of basic goods, due to the economic downturn.

The other segment Howard Schultz wanted to pursue involved dealing with the willingness to pay of the price-sensitive end of the market. This segment was being served by some of the competitors and Starbucks didn't want to lose the race. VIA was born in February 2009 out of this line of attack. It was a premium instant coffee with a worldwide market of an astonishing $21 billion[66]. The approach created controversy, "Starbucks may be waking up to reality and embracing its inner Walmart"[67].

It was first introduced in a number of chosen stores and it was a hit. People were adhering to the concept. It had sold $100 million in 10 months. Via would be sold not only in own stores, but also in REI, Compass, Office Depot, United Airlines, Barnes & Noble cafes, Marriott and Omni Hotels and later it was expected to get to mass grocery. Schultz's ambition was to create "additional usage occasions" and it would be a great weapon internationally also, once outside America, 40% of the coffee consumption was instant coffee[68] and for instance in Britain it was about 80%[69]. The CEO commented that VIA was a great innovation, and added that Starbucks could "integrate VIA into the emotional connection we have with our customers in our stores"[70]. The price was significantly lower than any other product offered in their shops, as each coffee would cost less than $1[71].

Another significant move towards a more mainstream segment was to push its Seattle's Best Coffee brand into fast food chains, such as Burger King and Subway, into movie theatres, coffeehouses and supermarkets. This was a clear response to the low cost competitors, namely McDonalds and Dunkin' Donuts, with Seattle's Best Coffee having reached a total of 30,000 locations in 2010. "Howard discovered, Wow, he's got this diamond in the rough of a brand that is part of the corporation, and we had not put the resources and the backing into it", said Michelle Gass, the president of Seattle's Best Coffee. The plan for this brand's future included its introduction at convenience stores, drive through kiosks and vending machines.

Starbucks most recent change was the redesigning of the logo, in January 2011 (Exhibit 21). It was a tactic to expand the brand into new directions. By dropping the words "Starbucks Coffee", it allowed them to better penetrate in new distribution channels, and with different kinds of products. Furthermore it was a sign of confidence, as Chris Allinson, the brand development project manager at the brand consultancy Added Value said "It shows that Starbucks regards itself as iconic enough to remove its name".

The Path Ahead

Starbucks had been succeeding in most of its initiatives. The stock was at $32.13 in December 2010, and the revenues were $10.7 billion, with 71% coming from its U.S. operations. The total amount of stores was 16,858, from which 5,724 were international stores, spread across 55 countries. The current CEO was fairly convinced the company had pursued the right strategy, he stated: “To completely press the pause button and stop growing the company at that point. We also had to close underperforming stores, and we had to understand that in addition to preserving the core values, this was not a time to embrace the status quo as an operating proposition”. To him, the price that customers paid was completely justified by brand differentiation, namely through the quality coffee the company provided, the health care they granted their employees and what they gave back to communities[72]. "Going forward, we will continue to focus on what made us a different kind of company, one that balances profitability and social conscience, while providing exceptional shareholder value", promised the CEO to all stakeholders.

In the US market, Starbucks continued to search for more distribution channels, and will remain with a wide offer of food as complementary to its beverage business, as a means to continue to increase the average customer check[73]. Innovation in the drinks had always been a must, and to prove they were committed to it, in March 2011 there were four new product lines launchings to celebrate the company 40th anniversary. Convenience was still a very important driver for purchase in 2010, as it accounted for 36% of the decision “where to drink coffee”.

The most promising targets at this moment are the international markets, with emerging countries, namely China, India, Brazil and Russia gaining a special relevance due to their potential in terms of volume of customers. However, the growth will be faced with discipline, assured the CEO, ensuring that the company wasn’t going to get caught in the same trap. Adaptation to the culture was seen, by Starbucks, as crucial to a successful penetration into different countries, with a high degree of decentralization, trusting in the ones who really know the given market.

Regarding the segments targeted, attacking both a high end of the market and a more price-sensitive portion might lead to some confusion in brand image. Nonetheless, so far it has proven to be very profitable to serve the mainstream customer.

After 40 years doing business, Starbucks has undertaken some ups and downs, but has found its way around them, with Howard Schultz retaking a lead role. Under the attentive eyes of the analysts, the company has to manage to be profitable, maintaining a premium and responsible image. The big question that remains at this point is what does the future hold for Starbucks.

Exhibits

Exhibit 1: New Store Openings 1992-2000, with Howard Schultz as CEO

	1992	1993	1994	1995	1996	1997	1998	1999	2000
America	43	94	134	228	286	319	357	432	733
International	6	13	19	24	52	78	117	180	270
Year Total	49	107	153	252	338	397	474	612	1003
Cumulative Stores	49	156	309	561	899	1296	1770	2382	3385

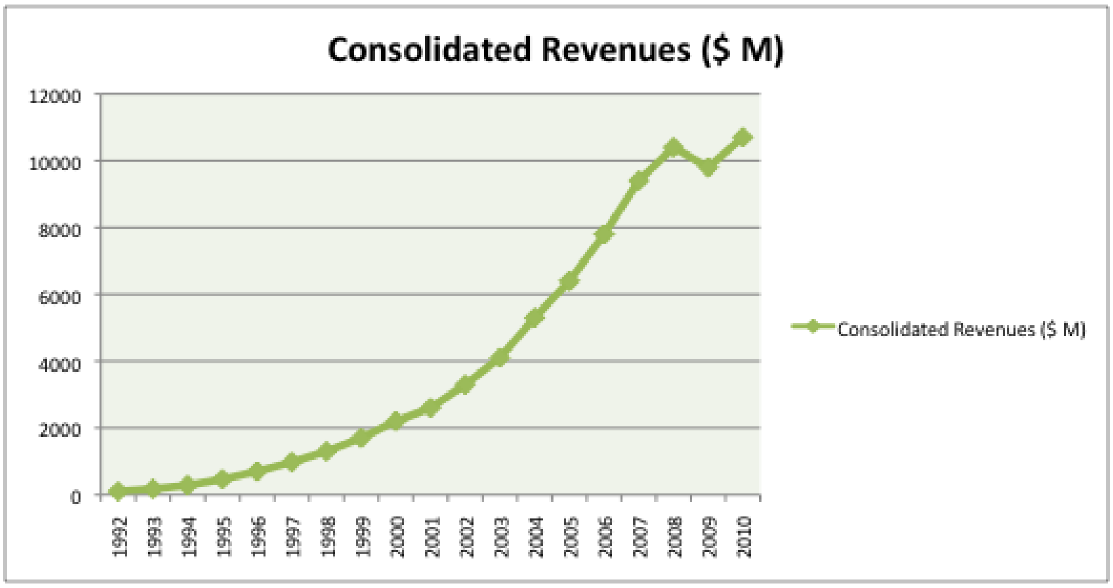
Source: Starbucks Coffee Company Website, “Store Counts: Net Store Opening”

Exhibit 2: International Store Openings

1996	Japan, Singapore
1997	Philippines
1998	Malaysia, New Zealand, Taiwan, Thailand, U.K.
1999	China, Kuwait, Lebanon, South Korea
2000	Australia, Bahrain, Hong Kong, Qatar, Saudi Arabia, United Arab Emirates
2001	Austria, Switzerland
2002	Germany, Greece, Indonesia, Mexico Oman, Puerto Rico, Spain
2003	Chile, Cyprus, Peru, Turkey
2004	France
2005	Bahamas, Ireland, Jordan
2006	Brazil, Egypt
2007	Romania, Russia
2008	Argentina, Bulgaria, Czech Republic, Portugal
2009	Poland, Aruba
2010	Hungary, El Salvador

Source: Starbucks Coffee Company Website, “Starbucks Company Timeline”

Exhibit 3: Consolidated Revenues evolution



Source: Starbucks Coffee Company Website, “Historical Revenue Summary”

Exhibit 4: New Store Openings 2000-2005, with Orin Smith as CEO

	2001	2002	2003	2004	2005
America	772	771	967	938	1176
International	436	406	372	406	496
Year Total	1208	1177	1339	1344	1672
Cumulative Stores	4593	5770	7109	8453	10125

Source: Starbucks Coffee Company Website, "Store Counts: Net Store Opening"

Exhibit 5: New Store Openings 2006-2007, with Jim Donald as CEO

	2006	2007
America	1543	1788
International	656	783
Year Total	2199	2571
Cumulative Stores	12324	14895

Source: Starbucks Coffee Company Website, "Store Counts: Net Store Opening"

Exhibit 6: Global Market Research by Synovate, October 2006

	Maroccos	Hong Kong	Brazil	US	Canada
Preffer Big Chains over Small Shops	74%	50%	49%	14%	11%

	Total	Singapore	Hong Kong	Brazil	Serbia	France	UK	US	Marroco	Australia
Big Chain are good because thay expand customer choices	76%	73%	78%	94%	81%	74%	73%	67%	84%	60%

Exhibit 7: Total Coffee Consumption by age and type, March 2008

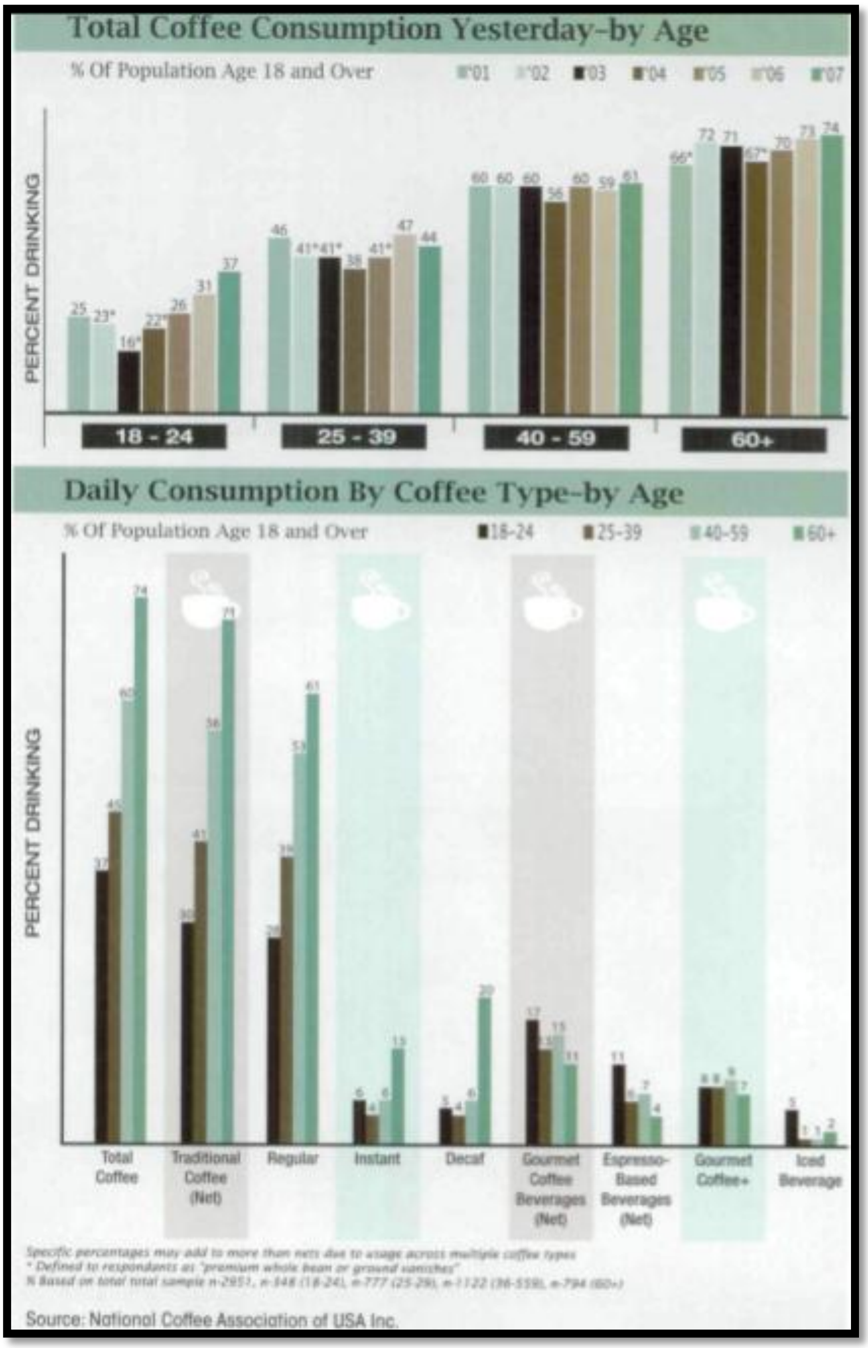


Exhibit 8: McDonalds Coffee reach and revenues

	Stores		Revenues $M	
	2007	2008	2007	2008
McDonalds	1300	7000	22800	23500

Source: McDonalds Annual reports.

Exhibit 9: Competitors comparison

a) Performance comparison

Company	Stores			Revenues		
	2005	2007	2008	2005	2007	2008
Caribou	395 (2)	484 (40)	511 (59)	161	257	254
Peet's Coffee & Tea	120	166	189	175	249	285
The Coffee Bean & Tea Leaf	400	650	750	150	130	
Panera Bread	877	1230	1325	640	1066	1299
Costa Coffee	617	1178	1288 (881 UK + 407 World)	270	428 (£216)	386 (£264)
Dunkin' Donuts	6000	7200	7900	3800	4400	5500

Note: brackets – international information

b) Strategy comparison comparison

Company	Strategy	Reach
Caribou	Specialty + environment	National
Peet's Coffee & Tea	Specialty + Mainstream (beans)	International
The Coffee Bean & Tea Leaf	Specialty	International
Panera Bread	Specialty Bread/Bakery-Cafe	National
Costa Coffee	Specialty	International
Dunkin' Donuts	Mainstream - beverages	International
McDonalds	Mainstream	International

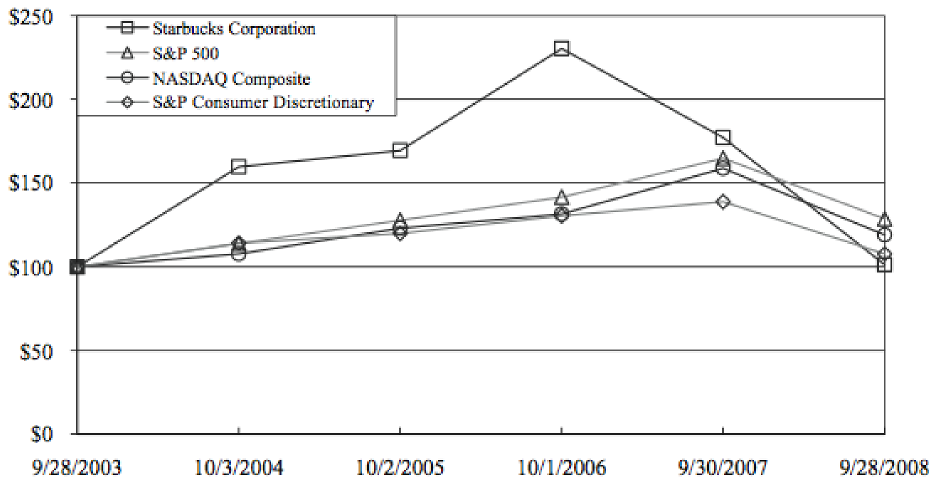
Exhibit 10: Starbucks evolution comparing to its industry

A) Stock price evolution from 2006 to 2011, comparing Starbucks (blue) with a sample of its competitors: Peet's Coffee (red), Panera Bread (yellow), Dunkin' Donuts (green), and Nasdaq Index (brown).

Source: Yahoo Finance, 31/05/2011

Note: Dunkin' Donuts is transacted under the name of the parent company Allied Domecq (AED). This company core business is related to alcoholic beverages, and therefore is not a representative competitor for Starbucks quote.

B) "Starbucks total return to shareholders from September 28, 2003 to September 28, 2008, relative to the performance of the Standard & Poor's 500 Index, the NASDAQ Composite Index, and the Standard & Poor's 500 Consumer Discretionary Sector, a peer group that includes Starbucks. Indices shown in the graph have been reset to a base of 100 as of September 28, 2003, and assume an investment of $100 on that date and the reinvestment of dividends paid since that date. Starbucks has never paid a dividend on its common stock. The stock price performance shown in the graph is not necessarily indicative of future price performance. "



Source: Starbucks Coffee Company, 2008 Annual Report.

Exhibit 11: GDP per capita evolution, United States

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
GDP - per capita (PPP) (US$)	28.894	30.364	31.687	33.332	35.081	35.898	36.797	38.196	40.309	42.534	44.663	46.627	47.209	45.989

Source: World Bank

Exhibit 12: Global Market Research by Synovate, October 2006

	Serbia	France	America	Hong Kong	Singapore
Couldn't live without at least a morning coffee	78%	67%	67%	21%	44%

Exhibit 13: Market value, market share and growth rate in the global Ready to Drink Coffee sector

Table 1: Market value (USD millions), market share (%) and growth rate (%) in the global RTD coffee sector, 2003 – 2012

Region	Country	2003	Share	2008	Share	2012	Share	CAGR 03-08	CAGR 08-12
Asia-Pacific		8,470.6	85.0%	8,578.5	82.0%	8,276.1	78.6%	0.3%	-0.9%
	Japan	8,052.1	80.8%	7,801.0	74.5%	7,059.2	67.0%	-0.6%	-2.5%
North America		934.7	9.4%	1,264.2	12.1%	1,540.0	14.6%	6.2%	5.1%
Europe		420.1	4.2%	447.2	4.3%	502.2	4.8%	1.3%	2.9%
South and Central America		109.3	1.1%	150.5	1.4%	188.0	1.8%	6.6%	5.7%
Middle East and Africa		25.4	0.3%	26.2	0.3%	27.4	0.3%	0.6%	1.1%
Total		**9,960.1**	**100.0%**	**10,466.6**	**100.0%**	**10,533.7**	**100.0%**	**1.0%**	**0.2%**

Source: Datamonitor Market Data Analysis DATAMONITOR

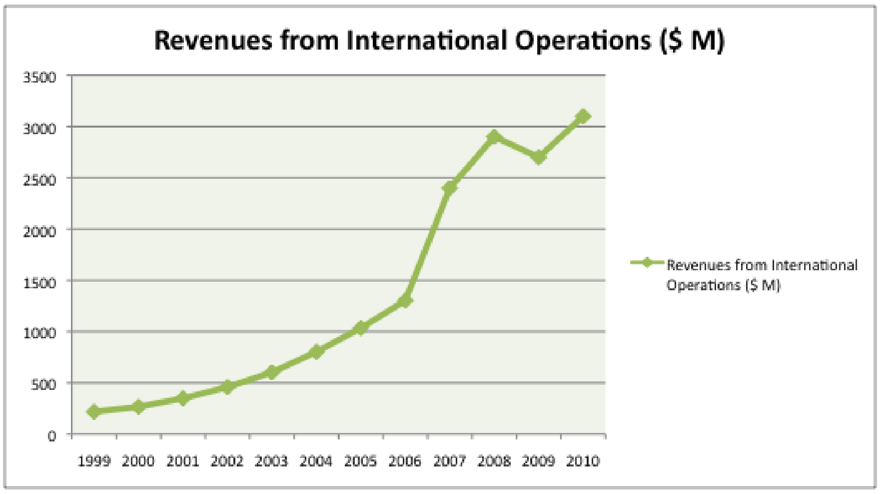
Source: Starbucks Case Study, March 2009. Datamonitor

Exhibit 14: Global Market Research by Synovate, October 2006

	Hong Kong	Singapore
Drink coffee in the morning	21%	44%
Drink coffee throughout the day	12%	31%

Exhibit 15: Starbucks Logo VS. Shanghai Xingbake Café Logo

Exhibit 16: International Revenues evolution



Source: Starbucks Coffee Company Website, Financial Releases

Exhibit 17: Comparison of cultures – USA vs. China

	USA	China
Most active period	Morning	Afternoon and night
Products most sold	Coffee	Coffee and food
Consumption	Take away	In store
Coffee as…	Need	Social event
Revenues origin	Frequency of transactions	High sales per customer
Efforts allocation	Increase efficiency	Increase store area and food offer

Source: Millares, Kristen, "Starbucks adjusts its formula in China; stores add food and room to chat for culture that doesn't take its coffee to go", *Seattle Post-Intelligencer*, June 16, 2005.

Exhibit 18: Entry Modes Examples

Entry Mode	Reasoning	Location
Own Store	High degree of consistency, discipline	North America
Joint Venture	Significant market differences or cultural issues, the risk and the costs of the entry were shared	Japan, Australia
Acquisition	Need for quick implementation and rapid growth in a fast moving market	U.K.
Licensing	Entry risk is too high, local partners absorb part of the costs and help the establishment of the brand	Singapore, Phillipines, Thailand, New Zealand, Malaysia, South Korea, Indonesia

Exhibit 19: Howard Schultz's email to Jim Donald

From: Howard Schultz

Sent: Wednesday, February 14, 2007 10:39 AM Pacific Standard Time

To: Jim Donald

Cc: Anne Saunders; Dave Pace; Dorothy Kim; Gerry Lopez; Jim Alling; Ken Lombard; Martin Coles; Michael Casey; Michelle Gass; Paula Boggs; Sandra Taylor

Subject: The Commoditization of the Starbucks Experience

As you prepare for the FY 08 strategic planning process, I want to share some of my thoughts with you.

Over the past ten years, in order to achieve the growth, development, and scale necessary to go from less than 1,000 stores to 13,000 stores and beyond, we have had to make a series of decisions that, in retrospect, have lead to the watering down of the Starbucks experience, and, what some might call the commoditization of our brand.

Many of these decisions were probably right at the time, and on their own merit would not have created the dilution of the experience; but in this case, the sum is much greater and, unfortunately, much more damaging than the individual pieces. For example, when we went to automatic espresso machines, we solved a major problem in terms of speed of service and efficiency. At the same time, we overlooked the fact that we would remove much of the romance and theatre that was in play with the use of the La Marzocca machines. This specific decision became even more damaging when the height of the machines, which are now in thousands of stores, blocked the visual sight line the customer previously had to watch the drink being made, and for the intimate experience with the barista. This, coupled with the need for fresh roasted coffee in every North America city and every international market, moved us toward the decision and the need for flavor locked packaging. Again, the right decision at the right time, and once again I believe we overlooked the cause and the affect of flavor lock in our stores. We achieved fresh roasted bagged coffee, but at what cost? The loss of aroma -- perhaps the most powerful non-verbal signal we had in our stores; the loss of our people scooping fresh coffee from the bins and grinding it fresh in front of the customer, and once again stripping the store of tradition and our heritage? Then we moved to store design. Clearly we have had to streamline store design to gain efficiencies of scale and to make sure we had the ROI on sales to investment ratios that would satisfy the financial side of our business. However, one of the results has been stores that no longer have the soul of the past and reflect a chain of stores vs. the warm feeling of a neighborhood store. Some people even call our stores sterile, cookie cutter, no longer reflecting the passion our partners feel about our coffee. In fact, I am not sure people today even know we are roasting coffee. You certainly can't get the message from being in our stores. The merchandise, more art than science, is far removed from being the merchant that I believe we can be and certainly at a minimum should support the foundation of our coffee heritage. Some stores don't have coffee grinders, French presses from Bodum, or even coffee filters.

Now that I have provided you with a list of some of the underlying issues that I believe we need to solve, let me say at the outset that we have all been part of these decisions. I take full responsibility myself, but we desperately need to look into the mirror and realize it's time to get back to the core and make the changes necessary to evoke the heritage, the tradition, and the passion that we all have for the true Starbucks experience. While the current state of affairs for the most part is self induced, that has lead to competitors of all kinds, small and large coffee companies, fast food operators, and mom and pops, to position themselves in a way that creates awareness, trial and loyalty of people who previously have been Starbucks customers. This must be eradicated.

I have said for 20 years that our success is not an entitlement and now it's proving to be a reality. Let's be smarter about how we are spending our time, money and resources. Let's get back to the core. Push for innovation and do the things necessary to once again differentiate Starbucks from all others. We source and buy the highest quality coffee. We have built the most trusted brand in coffee in the world, and we have an enormous responsibility to both the people who have come before us and the 150,000 partners and their families who are relying on our stewardship.

Finally, I would like to acknowledge all that you do for Starbucks. Without your passion and commitment, we would not be where we are today.

Onward…

Source: http://starbucksgossip.typepad.com/_/2007/02/starbucks_chair_2.html

Exhibit 20: Starbucks and Competitors Advertisement Strategies

	Dunkin' Donuts	Starbucks	7-Eleven	Caribou
Campaign	"You kin' do it"	"It's more than coffee. It's Starbucks"	Recent coffee push touted "Brazilian Bold" blend	"Happy Monday"
Strategy	"Supporting" consumers during the downturn with price breaks, and touting coffee quality through occasional comparative advertising	Adding a drink and sandwich or muffin for $3.95 to its "value pairings," deepening environmental commitments for building its stores and sourcing its coffee	Raising the profile of its coffee while offering lower prices, such as a recent promotion of coffee and two taquitos for $1.99	Offering a medium cup of coffee for $1 on Mondays and a pound for $8.99; focusing on Rainforest Alliance, fair-trade and organic options
Agency	Hill Holliday, Boston	BBDO, New York	FreshWorks	Colle & McVoy, Minneapolis
Media	TV, Internet, print, radio, outdoor, social	TV, Internet, print, radio, outdoor, social	Radio, outdoor, in-store	Radio, Internet, social

Source: Emily Bryson York, "Java Giants Brace for McCafé," *Advertising Age*, May 4, 2009.

Exhibit 21: Starbucks' New Logo

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IV. Teaching Note

Synopsis

Starbucks was founded in Seattle, in 1971, by Jerry Baldwin, Zev Ziegler and Gordon Bowker, but it was not until sixteen years later that it gained the image it has today. Howard Schultz was the one who, back in 1987, bought this company and gave it a unique concept; he wanted to create a social hub with high quality coffee and strong corporate and social responsibility, focusing mostly on the people. He came across this idea when, in a business trip to Milan, he saw himself in a city with small coffee shops everywhere, serving exquisite drinks, and also functioning as gathering locations. By that time, there was no such concept in America, nor high quality coffee, the market had much space to grow. It was a breakthrough that changed the way Americans flavoured their coffee and how much they were willing to pay for it.

Starbucks came to create a market for specialty drinks and it expanded exponentially throughout decades, under the mandate of three CEOs, Howard Schultz, the founder; Orin Smith, a retail veteran; and Jim Donald, a Starbucks educated employee. It grew from six Seattle-based stores to a 17.000 giant, spread throughout the world. Along the way it changed from the “people’s front porch” original idea, to an efficiency and performance focused company, loosing much of its original identity.

By 2008, Howard Schultz was forced to return to his former CEO position, in order to put Starbucks back on track. The company was dropping on market share value, as well as in sales per store. Across the world consumer preferences had changed, some of which Starbucks did not pay attention to, and the American economic downturn in 2008 came to restrict discretionary budgets. Also some low cost competitors entered in the market, namely McDonalds, which, given the customer’s limitations in spending and the number of stores it had, was affecting Starbucks.

Schultz addressed the existing issues by first trying to understand the market and then formulating a strategy accordingly. To do this, he reorganized the executive team, keeping only two of the ten elements and replacing the rest, and conducted surveys to customers and employees, also known as partners. With the input of the workers, he was able to better motivate them in order to create a tighter community, trying to avoid the usually high turnover. Adaptation to customer's tastes and needs was a must and Starbucks did this through matching drinks and food to each place, but still maintaining some degree of standardization across the company. Also the design of each shop was rethought to create a better fit with the routine of the given clients. The coffee quality and the experience provided were also improved. International markets gained more and more importance to Starbucks due to their unexplored potential when it came to specialty coffee, by 2008 they accounted for almost 30% of the company revenue.

This case examines how a company with such a success as Starbucks got lost on its own growth and failed to see what was really important, and later managed to overcome its obstacles with Howard Schultz' help.

The first section of the case is devoted to explaining the birth of Starbucks and the concept behind its success. It covers the early years of the company and the contribution Howard Schultz gave to the creation of the brand.

The second part is related to Starbucks' expansion, how it expanded under the mandates of the distinctive CEOs. It also denotes some of the market specificities along time that had impact on the growth, regarding America and also the rest of the globe, and finally the reaching of market saturation.

The third chapter explains the rationale behind the growth, as well as its impact on the company. These effects should be evaluated having in mind the value proposition Starbucks committed to offer.

The fourth section revolves around the return of Howard Schultz in 2008, and the measures he took to revive Starbucks' soul and performance. It describes the path the CEO chose to increase the value offered to customers, starting by changing the executives, paying attention to employees and to the market.

The last piece of the case describes the status of Starbucks in 2010, resuming the path the company went through and the challenges for the future.

Teaching Purpose

Starbucks' case is suited for students who have already undertaken basic Strategy and Management courses. It is to be taught in the undergraduate program or at Masters' level, in strategy subjects, with the purpose to teach students another face of growth, adding to the effect that market changes can have in a very profitable company.

The case requires students to:

- Analyse the external context in the coffee market along time, highlighting the changes that were occurring.
- Access what effects did the expansion have in the value proposition of Starbucks.
- Examine how Schultz's measures impacted Starbucks performance.
- Understand how the strategic decisions taken impacted the resource base.

The instructors should have already presented their students with the theory and a case dedicated to Dynamic Capabilities, so that they can better identify the shocks and dimensions in the Starbucks example. Compaq in Crisis by Adrian Elton is a good case to introduce the topic.

Intended Contribution

The Starbucks case illustrates first, how such a successful company that had been leading its industry for decades, is so vulnerable to market changes, namely consumer preferences and economic trends. It failed to be attentive to the environment, once the company was so distracted by its one growth. When not sensing market opportunities and threats, making timely and market oriented decisions, and changes in the resource base was very hard, having a negative impact on the company's performance. Secondly it is also very useful to demonstrate how strategic decisions, in this case taken by Howard Schultz, can affect the dimensions described in the dynamic capabilities view, and put a company back on track.

Instructor Preparation

For the instructor to be better prepared, it would be useful to be informed about the dynamic capabilities' view. For this purpose I suggest "Dynamic Capabilities: A Review of Past Research and an Agenda for the Future," (Ilídio Barreto, Journal of Management, January 2010). Students should also have been exposed to this literature by the time they read the present case.

Another important issue that should be covered by the instructor is the coffee market, and for that the report provided by Datamonitor "Global Hot Drinks – Industry Profile", dated October 2008. It describes the industry worldwide at the point of the American economical downturn, this way being a great help for the understanding of the context.

Datamonitor also has other relevant article regarding this case. It's the March 2009 "Starbucks Case Study". It helps the instructor to understand one of the most successful internationalization cases of Starbucks, the Japanese market. It is also very detailed regarding the ready to drink coffee, and its impact on the company.

At last, the instructor can benefit from the McKinsey Quarterly article "Starbucks' quest for healthy growth: An interview with Howard Schultz", issued in March 2011. It is a paper where the current CEO defined some of its strategies for the future that can help the instructor with the last section of the case.

Suggested Assignment Questions

Starbucks case first describes how such a successful and long lasting company failed to address market changes, and then describes how the firm was able to tackle most of the issues, taking decisions in line with the dimensions of the dynamic capabilities view. The instructor should cover the case with the following questions:

1. Regarding the external environment, what can be highlighted in Starbucks path that led to Howard Schultz return? Is there any discontinuity in the market?

With this question students should be able to identify two different periods: one, referring to when Starbucks got into the coffee market under Howard Schultz mandate; another, after

2006, leading to the CEO's comeback in 2008, due to firm's decreasing performance. It may also be possible to use a chronological approach.

The student should be able to recognize that important market changes occurred. However, there is no abrupt discontinuity to be mentioned. The specialty coffee market can be seen as an environment that evolved in a significant but not dramatic way.

The main aspects to highlight in the initial period are the following:

- Coffee culture was undeveloped, meaning it had space to grow
    - Expansion of coffee market, "having experienced a 157% growth between 2000 ($3,258m) and 2005 ($8,372m)"
- Few substitutes or similar competitor since there was no matching concept in America
- Premium coffee demand was increasing
- Chains were appreciated
- High quality suppliers used by Starbucks were not broadly used by competitors
- Increasing income per capita
- Trend towards social hubs supported by, for instance, the TV series Friends
- International markets:
    - Markets in development;
    - Not Starbucks' main focus.

In the second period, the environmental characteristics that should be emphasized are:

- Market saturation
- Specialty market much more developed: many competitors, including low cost players
- Specialty coffee demand rising
- American population preference for small coffee shops
- Subprime crisis creating budget restrictions: big impact on specialty goods
- The atmosphere of a coffee shop was not a decisive factor for most Americans

- A growing "Ready to Drink" market
- Aging demographics
- International markets:
    - Increased market value and coffee addiction;
    - Chains preference over small shops;
    - American brand were highly regarded;
    - The atmosphere factor was valued;
    - Emergence of copycats.

2. What did Starbucks offer that led to the wide adoption of the brand? How did the value proposition change over time? Please focus on the American market.

First, the original value proposition offered by Starbucks should be emphasized:

- Quality products: farmers were motivated to produce high quality beans due to the ethical relationship Starbucks created, rewarding them with fair prices and caring for sustainability. There was a large offer of customized, yet consistent drinks. High quality coffee was not usually available in coffee shops America.
- Consumer Service: clients were served by baristas whose goal was to create a relationship. Customer preferences were always under the employees´ attentive eye. Baristas were rewarded above the market average, in order to make them satisfied and therefore creating a community spirit.
- Atmosphere: the design of the shops was inviting, proving the "people's front porch".

Second, the student should devote time to explain the evolution of the above-mentioned proposition.

- Quality products:
    - Pro: increased diversity of drinks.
    - Cons: attention deviated from the coffee with the introduction of so many dispersed products.
- Consumer Service:

    - Pro: introduction of prepaid card simplifying transactions.
    - Cons: baristas could no longer be attentive to customer preferences; focus on efficiency.
- Atmosphere:
    - Cons: Standardization of design.

3. In what way did Starbucks fail, leading to the decrease in performance? Please consider the dynamic capabilities view in your analysis.

It is important that the student understands that more than one variable contributed for the decrease in Starbucks' performance. First, the answer should have explicit that the economic downturn was not the cause for the tumble. In 2006, Starbucks started displaying evidences of problems, well before the economic crisis took place. Moreover, many competitors did not have the same negative impact on performance, confirming the fact that the economic downturn was not the problem or else it would have affected the entire industry.

It is also relevant to note that Starbucks struggled mainly in the American market, while the international market was thriving.

The real issue that affected this company was its lack of perception of the evolution of the market (consumer trends mostly) and, in consequence, there was a lack of timely and market-oriented decisions. In result, they also did not change their resources to better fit the market. Starbucks was inebriated by its growth, everything seemed to work, wherever and whenever they opened a store.

It is clear that the sensing of opportunities was relatively low in this period. First, Starbucks failed to sense the changing consumer preferences evolving towards familiar shops, with differentiated features and a community sense, and went in the opposite direction. Then, the firm did not understand the market need for a quality service, and took counter market-oriented decisions, based on the stock price. Furthermore, the retailer did not realize the demographic shock or the implications that the mortgage crisis would have. Another important change that Starbucks failed to sense was the increasing potential of international markets, namely emergent countries.

The propensity to make timely decisions was also low. Starbucks did not make the decisions ahead of competitors, instead it reacted when negative effects were visible. The firm was not capable of sensing the changes in the market, so it could not have a quick response to them.

Starbucks propensity to make market oriented decisions was also at a low level. This dimension was negatively affected by the lack of market sense. Considering that the firm was not aware of market changes, it could not make decisions in response to those changes. The lack of market consciousness led Starbucks to make several counter market-oriented decisions, namely the standardization of stores, the focus on efficiency rather than on the customers, among others.

The propensity to change the resource base was jeopardized by the low levels scored on the other dimensions, and, in consequence, was also low. As the company did not understand the importance of the customer experience, it did not bet on employees' know how, motivation or loyalty either. Instead, it adopted such big automated machines that diminished the relationship between baristas and clients by diminishing the eye contact and did not allow the usage of the coffee-making skills of the employees.

Starbucks showed a low level of dynamic capabilities at this point and it was not achieving the adaptation required to maintain its strong market position.

Sensing opportunities and threats: Low

Making timely decisions: Low

Making market-oriented decisions: Low

Changing resource base: Low

4. What strategic decisions did Howard Schultz make regarding the dynamic capabilities' dimensions? How did they contribute to an improved performance?

The present question requires the student to identify what decisions the CEO made, while connecting them to the dynamic capabilities' dimensions. The first fact to denote is that there were two distinctive markets, the North American and the International one, and each of them asked for different adaptations within the same overall strategy.

Howard Schultz's first decision was to go back to the core, focus on people, adapt Starbucks to customers and increase visibility. From this point on, the CEO was committed to adopt a disciplined growth. The American market required more attention since it was where the performance had decreased the most. International markets were not so affected due to the fact that preferences prevailing there were different, and furthermore, American brands tend to have foreign fans just because of their country of origin.

Most decisions made after Schultz's comeback can be viewed along the dynamic capabilities' dimensions. The sense opportunities and threats was confirmed by the following:

- Sense the huge market for instant coffee - VIA
- Increase of people drinking coffee at home – investment in the availability of Starbucks products in groceries and other channels
- Sense the threat of McDonalds increasing its coffee network – push Seattle's Best Coffee into chains
- Implement consumer surveys + online forum: allow sensing opportunities in the future

Regarding the propensity to make timely decisions, Starbucks did not take most of the decisions in a timely manner until this point. They were a reaction to the decrease in performance, not anticipation because they were not attentive to market opportunities/threats. However, with the new systems Howard Schultz was implementing, the company had, at this point, a structure that allowed acting quickly according to changes.

The propensity to make market-oriented decisions was visible in the company and could be seen in several situations:

- Adapt drinks and design locally – enabled by the customer surveys
- Implement customer suggested measures - Internet forum
- Introduce VIA – response to a need in the market
- Increase distributions channels (groceries…) – response to a growing demand
- International markets: keep Starbucks brand visible VS American local adaptation: "15th Ave. Coffee & Tea"
- Increase visibility of social initiatives: diminish critics of the market and create a community

There also many evidences of changes in the resource base after 2008:

- Comeback of Schultz to the former CEO position
- Reduce in the number of stores - extend the survival of the company, while doing the required changes
- Reorganize executives – create and implement the strategy
- Train baristas – provide better service, motivation, know how
- Improve baristas satisfaction to decrease turnover – create community sense
- Acquire Coffee Equipment Company - provide better coffee quality
- Introduce Seattle Best Coffee brand in low costs chains
- Redesign logo
- Allocate more resources to international markets

Sensing opportunities and threats: Medium/ High

Making timely decisions: Medium

Making market-oriented decisions: Medium/ High

Changing resource base: High

The company suffered many alterations, which enabled Starbucks to better face changes in the market, through adaptation. With these measures, the retailer improved its performance, fact that the instructor can demonstrate with a simple stock price evolution chart.

5. (Optional Question) What is your opinion regarding Howard Schultz strategic decision of targeting both higher and lower end of the market? Guidelines:

One interesting question that could arise in class is related with Starbucks strategy to target both high and low ends of the market. The instructor could address this matter by highlighting the dilemma between benefits and issue of pursuing such approach.

As benefits the instructor could mention the expansion of market reach, with the lower-end having a great potential in terms of volume. There's also little overlap of the two segments, since one wants the quality experience while the other just wants a quick coffee.

The most significant issues related with this strategy is the confusion in the brand image. The premium quality standard Starbucks offered, was what led people to be willing to pay for such high margins, and it could be damaged by targeting the mainstream segment.

Teaching Plan

The Starbucks teaching case is prepared for a 90 minutes class, given that the students are already familiarized with the dynamic capabilities' view, and have examined the case. The suggestion below doesn't include the optional question, if the instructor chooses to present it, the plan must be adapted to it.

10 min	• Review Dynamic Capabilities view
15 min	• Summarize the Starbucks case
10 min	• Question 1
10 min	• Question 2
15 min	• Question 3
20 min	• Question 4
10 min	• Wrap up

V. Discussion

The following discussion is intended to relate the dynamic capabilities view to the Starbucks case. First, it is noteworthy to recall the definition proposed by Barreto (2010), since it is the most consistent one and summarizes the main elements mentioned in the previously proposed definitions: "A dynamic capability is the firm's potential to systematically solve problems, formed by its propensity to sense opportunities and threats, to make timely and market-oriented decisions, and to change its resource base."

Success is a hard achievement, and the key to get it is still somewhat of a mystery. Michael Porter's industrial organization model did not hold as a sufficient explanation. Giving emphasis to the external context is important, but research has suggested it is not enough to be successful (Adner and Helfat, 2003). The Starbucks' case seems to support these findings: the company entered the coffee market in a period in which the industry was experiencing an overall decline in sales, making its attractiveness doubtful; nonetheless, the retailer was able to create its own demand and enjoy a huge success for many years.

It was a firm specificity that led to such a good performance. The RBV theory could nicely explain the initial period of Starbucks, but it would fail to explain why did Starbucks' performance decrease after 2006 and improve latter on. In dynamic markets that undergo consecutive shocks, firms are required to adapt. The failure to anticipate and adapt to several changes led to Starbucks' tumble.

In contrast with other theories, the dynamic capabilities view explicitly contemplates changes in the environment and the ability to adapt to them, through its four dimensions (Barreto, 2010). These dimensions need to coexist in a company at a sufficiently high level, in order to enable firm's adaptation.

Under this view it is possible to offer a better explanation for the history of a company such as Starbucks. As markets are very competitive and constantly changing, the "potential to systematically solve problems" is crucial to keep up with the setting. However, dynamic capabilities are not only helpful in highly dynamic environments, it has been suggested that they can also be important in moderately dynamic contexts, as argued by Eisenhardt and

Martin (2000). Paying attention to all four elements of the dynamic capabilities' definition is essential, as well as the interdependence among them (Teece, 2007; Pablo *et al.*, 2007).

The propensity to sense market opportunities and threats, also known as monitoring capability (Schreyögg and Kliesch-Eberl, 2007), has been considered key to the dynamic capabilities view, as it is the dimension that allows spotting the market changes. Gilbert (2006) added that capabilities could suit the internal context of a company, while not fitting the environment. Another important issue about the dynamic capabilities' dimensions is that they are somewhat dependent on each other (Barreto, 2010). Starbucks case illustrates quite well the relevance of the propensity to sense market opportunities and threats, as well as the relations that can exist between dimensions.

First, it was the sensing of a market opportunity that led Howard Schultz to buy Starbucks, and implement his concept of a social hub with quality coffee. This enabled him to enjoy a major success for many decades. However, at a second stage, Starbucks was so inebriated by its success and growth that it stopped being attentive to the market. This issue was especially noticeable in the American market. Everything the company was doing seemed to have worked, so they just kept doing it, and did not monitor the market changes. The retailer did not see the consumer preferences evolution, or the demographic change, or even the severity of the economic downturn. The firm fell in a trap and lost its way.

Adding to this, the low level of propensity to sense opportunities and threats had a negative effect on the other dimensions. Since Starbucks did not see the changes in the market, it did not have the tools to make decisions ahead of competitors, neither to make decisions that fitted the market. In consequence, the resource base was not properly adapted to respond to changes. The first dimension undermined all the others, and it functioned as a cascade, leading to a low level of dynamic capabilities. Starbucks did not make an effort to build consecutive competitive advantages by adapting to market changes. It was blind by the success it had been experiencing.

With Schultz's comeback, Starbucks installed mechanisms that allowed them to sense market opportunities and threats, such as the online forum and the customer surveys. The management team was also more focused on the market characteristics, rather than on growth. All of these changes had a very positive impact on the company's performance. Furthermore, a higher level on this dimension enabled higher degrees on the others.

The propensity to make timely decisions has been discussed since the appearance of the dynamic capabilities' view. Teece *et al.* (1997) mentioned this element by expressing the need to act "quickly", and later, Adner and Helfat (2003) had referred that timing was as important as the content of the decision. The Starbucks case helps to illustrate the importance of timely decision making. Its handicap on market sensing in the first period diminished its capability of making decisions in a timely manner. During the high growth period, under the mandates of Orin Smith and Jim Donald, Starbucks was not making fast decisions, it just reacted and did not anticipate changes. The retailer simply put the market-oriented decisions on hold until the moment Howard Schultz retuned. For instance, it only started moving away from the standardization with Schultz, several years after the preference for familiar environments had emerged. When Schultz's returned, he tried to create mechanisms to better understand the market, and consequently it was expectable that timely decisions would be facilitated.

The third dimension in the definition, the propensity to make market-oriented decisions is crucial to achieve a successful market adaptation. The content together with the right timing (Adner and Helfat, 2003) helps providing value to the customers and keeping ahead of competition. The propensity to sense opportunities/threats has a strong influence in the decision making process (making market oriented decisions). The latter was found to be only relevant if the former was satisfied (Gilbert, 2006). Additional insights can be provided by the Starbucks case regarding this matter. The lack of market sensing led to poor decisions in the period that ended with Schultz's comeback. Consumer preferences evolved and Starbucks was not on top of it. American customers were willing to pay for a Starbucks product due to the experience they got and not only for the product. Whereas the market asked for differentiation, Starbucks started to bet on efficiency, and this was only one of the many counter market-oriented decisions the company made. After 2008, the CEO tried to tackle this issue, first by creating the base for sensing opportunities and threats and then to act accordingly to the market. He decided to adapt products and the design to meet market requests and also invested in the community sense to enhance the experience. He launched the VIA instant coffee to get advantage of the huge market potential, expanded distribution channels to respond to the increasing home coffee consumption, and focused his attention on the very promising international activities.

The propensity to change the resource base is the last dimension in the dynamic capabilities' definition, but it is the final crucial step to achieve market adaptation. It has been mentioned by other authors (e.g. Eisenhardt and Martin, 2000; Helfat *et al.*, 2007), and it contemplates the creation, extension and reconfiguration (Teece et al., 1997) of firm resources to fit the strategic decisions. Management teams have an essential role on making the decisions and therefore enabling the resource base change (Pablo *et al*., 2007). Also, higher levels of the previous three dimensions will positively affect the degree of change in resource (Menguc and Auh, 2006). The Starbucks case demonstrates clearly the impact of the quality of the first three dimensions in the last one. During its astonishing growth phase Starbucks could not correctly adapt the resource base accordingly to timely and market-oriented decisions because it did not sensed what was happening in the market. The executive team was chosen on its experience to create growth, and not on the capacity to improve customer service. Everything was adapted to fit growth.

Howard Schultz was able to address most of the dimensions proposed in the dynamic capabilities definition after his comeback, and then, the company was able to accomplish a higher level at the dimensions. The management team, with Schultz heading it, made a huge difference. Growth was no longer the priority, serving the market became fundamental. By making an effort to sense opportunities and threats and installing systems that allowed continuing to do so, they were able to make market oriented and timely decisions, as well as adapting the resources to the strategic decisions. They adapted the company resources in order to improve the experience provided to customers, and dealt with several key areas such: as executives aligned with the company strategy; employees' know how through training; motivation with engagement initiatives; loyalty through the reward program with the prepaid card; acquisitions to improve the quality of the product, among other adaptations.

Thus, Starbucks quest for success is intimately connected with the dynamic capabilities' view. Its ups and downs can be explained with respectively higher and lower levels of the dimensions of this view.

The dynamic capabilities' view has implicit the existence of a shock, which is commonly known as an abrupt change in the market. Eisenhardt and Martin (2000) have stated that having dynamic capabilities is beneficial in any kind of market dynamism, meaning that implementing dynamic capabilities does not require high-velocity market with abrupt changes. Moderately dynamic environments, with somewhat predictable paths also benefit from this view, but here the dynamic capabilities resemble routines, that begin with the analysis of the market and end with its implementation (Eisenhardt and Martin, 2000). Starbucks path is a good evidence of company inserted in an industry that, although changing, there is no abrupt shock, and still there is a need for dynamic capabilities. The gradual changes in consumer preferences that went unnoticed affected negatively Starbucks' performance and the demographic change also took a toll in their performance. The most visible shock was the economic downturn in 2008, however it was not responsible for the decrease in performance that Starbucks went through, since this fall was already visible in 2006 stock price, but it certainly did not assist the retailer in its quest for success. In the moment that Schultz restored good levels in all the dynamic capabilities' dimensions, the company improved the performance.

In sum, it is important to understand the importance of each of the dimensions in the dynamic capabilities view and how they relate, as well as the usefulness of the vision in any firm and market.

VI. Conclusion

Dynamic capabilities view has been suggested as an important theoretical explanation for companies' success in turbulent environments. It has been widely used in the literature, but more research seems required in order to build a more consistent theory.

Barreto (2010) has put forward a new and improved definition as well as a review of the past literature. This dissertation was built around such a conceptualization.

Starbucks case illustrates how important having dynamic capabilities can be, even for well established firms. The company enjoyed such a success, and expanded so much, with everything always working out, that they forgot to continue to be attentive and adapt to the market and just kept doing the same. With few capabilities towards sensing the changes in the external context, Starbucks had no structure to develop the other three dimensions, and this had a strongly negative impact on its performance.

Howard Schultz was forced to return to his former CEO position and corrected these issues, providing the company with stronger dynamic capabilities, especially by implementing systems that allowed Starbuck to be on top of market evolution, to which it would adapt. In the future, the quest for Starbucks will be to maintain a strong brand image, grow with discipline and continue to build consecutive competitive advantages.

The aim of this thesis was to illustrate the dynamic capabilities view with a real life case, providing additional evidence for the importance of this novel theory to the business world. I concluded not only that dynamic capabilities seem relevant but also that its four dimensions seem crucial for firms' adaptation to changing environments.

VII. References

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