



## **Starbucks**

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## Starbucks

- Return over-holding period (June 26<sup>th</sup>, 1992 – June 30<sup>th</sup>, 2024): 29,772% (19.5% annualized return)

Figure 1: Returns

	Total Returns		Annualized Returns	
	Starbucks	S&P 500	Starbucks	S&P 500
2-Year	151%	17%	58%	8%
3-Year	241%	47%	50%	14%
5-Year	624%	149%	49%	20%
From IPO (6/26/1992 – 6/30/2024)	29,772%	2,429%	19%	11%

Notes:

- Total return and annualized return data for both the S&P 500 and Starbucks include dividends reinvested and are split-adjusted.
- The start date for the return data above is 6/26/1992, which was the day of Starbucks' IPO. Its split-adjusted price was \$0.27 per share.
- The end dates for the time periods above are two years, three years, and five years after the IPO date.

## Mental Model Summary Derived from Starbucks

- A focus on a rapidly growing market, higher-quality-centric (more appealing to consumer) segment growing low-to-mid teens. The market was driven by a product that was a very low percentage (0.1% to 3%) of an individual's income and simultaneously also a highly addictive product.**
  - Starbucks ensured a high-quality cup of coffee by purchasing only arabica green beans directly from the best coffee-producing regions worldwide and roasting them in-house in small batches to maintain consistency and meet its high standards, which it was able to scale. According to the World Demand Prospect For Coffee in 1980, a research conducted by the U.S. Department of Agriculture, arabica beans have a softer and milder flavor, making them more appealing to consumers, unlike robusta beans, which are coarse and pungent, often used in lower-quality blends and instant coffee.<sup>1</sup>
  - The broad coffee market in the US at Starbucks IPO was predominantly lower quality beans (robusta) while Starbucks only used the best quality beans (arabica). In 1989, the gourmet coffee segment was the only part of the coffee market that continued to grow while the overall market was in decline. The per capita availability—a proxy for consumption—was nearly 40% lower than its peak in the 1940s and continued to decline. In 1989, Starbucks played in two sub-segments under gourmet coffee,<sup>2</sup> the “true” gourmet coffee market and the premium coffee market, both of which are considered premium in the overall coffee market. The earliest pre-IPO data shows that, the “true” gourmet coffee segment accounted for over 10% of all coffee sales. Starbucks, with store sales of only \$16 million in 1989, held an estimated 2% market share in the U.S. gourmet coffee market, forecasting that the true gourmet coffee market would grow by 9% annually to \$1.05 billion by 1994. In addition, the premium coffee market was expected to grow by 19% annually to \$681 million over the same period. **This implied a blended market growth rate for Starbucks of low to mid-teens. By 2023, market research revealed that the branded coffee shop sector in the U.S. has grown to \$49.5 billion in value,<sup>3</sup> a nearly 14% CAGR over approximately 31 years since Starbucks went public in 1992.**
  - Furthermore, the landscape of coffee shops in the U.S. underwent a significant transformation, expanding from a modest 2,850 establishments in 1993 to over 40,000 by 2022. One of Starbucks' competitors stated that part of this remarkable growth was catalyzed by Starbucks heightening people's awareness of specialty coffee.<sup>4</sup> A survey conducted by the National Association of Specialty Food Trade revealed that the consumption of specialty coffee rose significantly from 22% in 1990 to 31% in 1992 whereas the consumption

<sup>1</sup> Pg. 9, World Demand Prospects for Coffee in 1980. U.S. Department of Agriculture.

<sup>2</sup> Also known as “specialty coffee”, include true gourmet coffee (arabica coffee sold in whole bean and ground form), premium coffee (upscale coffee mass marketed by leading coffee companies), and decaffeinated coffee. Starbucks Prospectus.

<sup>3</sup> Buoyant US Branded Coffee Shop Market Exceeds 40,000 Outlets for The First Time.

<https://www.worldcoffeeportal.com/Latest/News/2023/October/Buoyant-US-branded-coffee-shop-market-exceeds-40,0>

<sup>4</sup> Discussion with Martin Diedrich.

of commercial coffee declined from 67% to 62% during this period.<sup>5</sup> Today, Starbucks commands a substantial 40% share of the branded coffee shop market in the U.S.

- d. Since Starbucks went public, the average urban household in the U.S. has allocated less than 0.3% of its total expenses to coffee consumption.<sup>6</sup> For these individuals, the daily enjoyment of coffee at Starbucks does not pose a significant financial burden. Depending on their income levels, **expenses on daily coffee purchases at Starbucks typically range from 0.1% to 3%,<sup>7</sup> allowing them to indulge in their favorite brew without undue financial strain.** In a survey conducted in Seattle in 1992, it was found that Starbucks sold its coffee at nearly \$9 per pound, while most other brands sold in a price range between \$2 and \$7. As a result, Starbucks's ability to charge a premium price for its product enabled it to maintain a high gross margin, expanding from 50% to over 60% throughout its history. This relatively modest portion of household expenditure on coffee suggests that daily coffee consumption would not strain household budgets significantly. In addition, regular consumption of coffee leads to both psychological and physical dependency due to caffeine's effect such as giving consumers a sense of well-being, alertness, and sociability. Consequently, for many professionals, coffee becomes an indispensable part of their daily routine, serving not only as a source of stimulation but also as a means to stave off withdrawal effects. Coffee is attractive to all socioeconomic groups and Starbucks attracts customers from diverse socioeconomic backgrounds, including utility workers, police officers, white-collar professionals, and surgeons.

2. **Starbucks sold a product that was both a very small percentage of household income (~1%) and one that was consumed habitually on a daily basis by customers. This leads to both a very high willingness to spend and very high ability to spend on the product Starbucks was selling, leading to very high re-occurring revenue.**
  - a. Depending on their income levels, **expenses on daily coffee purchases at Starbucks typically range from 0.1% to 3%,<sup>8</sup> allowing them to indulge in their favorite brew without undue financial strain.** In a survey conducted in Seattle in 1992, it was found that Starbucks sold its coffee at nearly \$9 per pound, while most other brands sold in a price range between \$2 and \$7. As a result, Starbucks's ability to charge a premium price for its product enabled it to maintain a high gross margin, expanding from 50% to over 60% throughout its history.
  - b. According to surveys, in 1992, about half of the people (50%) 10-years-old or older drank at least a cup of coffee a day;<sup>9</sup> in 2018, 64% of Americans aged 18 or over drank coffee.<sup>10</sup>
  - c. The re-occurring revenue nature of Starbucks can be seen by its consistent track record of positive same-store sales. Starbucks has continued to grow organically for most of the years throughout its history (22% sales CAGR from FY1991 to FY2023, with an average growth rate of 6% on comparable store sales). The company has only seen 3 fiscal years with declines during its development, which were in 2008 and 2009 during the Great Financial Crisis and 2020 during the Global Pandemic.
3. **Starbucks had an impressive payback period for its stores, typically falling below the two-year mark from IPO. The store base itself since IPO has compounded at an incredible CAGR of nearly 20% over 30+ years.** Such rapid payback on its investment at the store level enables the company to swiftly capitalize on market opportunities and expand its footprint. From March 1992, before its IPO, to Q2 2024, Starbucks experienced remarkable growth in its store count. During this period, the number of stores surged from 126 to 38,951,<sup>11</sup> representing a CAGR of nearly 20%.

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<sup>5</sup> UNFILTERED ECSTASY SPECIALTY COFFEE CAFES, EMPORIUMS A RAPIDLY RISING 'SOCIAL PHENOMENON'. 7/24/1994.

<sup>6</sup> Food Spending in American Households 1980-92. U.S. Economic Research Service, Washington, DC.

<sup>7</sup> Average doctor's pay for 1992: \$177,400. <https://www.tampabay.com/archive/1994/02/12/average-doctor-s-pay-for-1992-177400/#:~:text=All%20physicians%3A%20%24177%2C400%20average%2C%20%24148%2C000,Surgery%3A%20%24244%2C600%2C%20%24207%2C000.>

<sup>8</sup> Average doctor's pay for 1992: \$177,400. <https://www.tampabay.com/archive/1994/02/12/average-doctor-s-pay-for-1992-177400/#:~:text=All%20physicians%3A%20%24177%2C400%20average%2C%20%24148%2C000,Surgery%3A%20%24244%2C600%2C%20%24207%2C000.>

<sup>9</sup> Americans Wake Up and Smell the Coffee. <https://www.nytimes.com/1992/09/02/garden/americans-wake-up-and-smell-the-coffee.html>

<sup>10</sup> Americans Are Drinking A Daily Cup of Coffee At The Highest Level in Six Years.

<https://www.reuters.com/article/idUSKCN1GT0KT/#:~:text=Daily%20coffee%20consumption%20declined%20into,demand%20growt%20for%20other%20products.>

<sup>11</sup> Starbucks Q2 Fiscal 2024 Results. [https://investor.starbucks.com/press-releases/financial-releases/press-release-details/2024/Starbucks-Reports-Q2-Fiscal-2024-Results/default.aspx.](https://investor.starbucks.com/press-releases/financial-releases/press-release-details/2024/Starbucks-Reports-Q2-Fiscal-2024-Results/default.aspx)

4. **Starbucks' maniacal, obsessive (almost irrational) focus on the highest quality across all aspects of its business (i.e. products, service, people, restaurant locations, ambiance/design, etc.) created a brand synonymous with quality, consistency, and affordable luxury.**
  - a. Starbucks ensured the quality of its coffee by purchasing only arabica green beans directly from coffee-producing regions worldwide such as Sumantra and Costa Rica and roasting them in-house in small batches to maintain consistency and meet its high standards. In addition, the company standardizes its coffee-brewing process for different drinks including strict controls on the weight of coffee beans per dose, grinding coarseness, water temperature, pressure, and brewing time.
  - b. The company requires a total of 24 hours of classroom training for each employee within the first six weeks of employment and on-the-job training focusing on coffee and equipment knowledge, customer service, sales skills, and beverage preparation. Employees are friendly and knowledgeable and are willing to remake coffees for unsatisfied customers. The company enables employees to become stakeholders in the company, granting them ownership of a share of the business. As they continue to work and contribute to the growth of the company, they have the potential to increase their stake, fostering a sense of collective ownership and collaboration in building the business together. Employees were treated as owners (i.e. benefits, employee stock programs, education benefits, etc.) and this led to lower employee turnover, around 60%-65% compared to other retailers and fast-food chains where turnover can range from 150% to 400%,<sup>12</sup> and a more engaged employee base.<sup>13</sup> **Lower employee turnover and a more engaged employee base in turn creates more consistent, high customer service levels.**
  - c. Starbucks has its in-house design team for its store layouts so that each store is designed to reflect the unique character of its neighborhood while maintaining a consistent look that identifies it as part of the Starbucks family.<sup>14</sup> In addition, the store is filled with the aroma of freshly brewed coffee fills the air, creating a rich and inviting atmosphere that even non-coffee drinkers find appealing. Even the background music at Starbucks is just as thoughtfully selected, with a diverse range of genres such as classical and jazz.<sup>15</sup>
  - d. Starbucks has earned a reputation as one of the best brands across continents. Fortune named Starbucks No. 1 in the Food Service industry and 14th overall in its "World's Most Admired Companies" rankings for 2023.<sup>16</sup>
  
5. **Starbucks employs various positive feedback loops to enhance its value proposition with customers (a more personalized experience) and improve its product offering.**
  - a. **Starbucks Rewards** - The Starbucks Reward program stands out as a significant feedback loop, employing gamification to incentivize customer retention. For instance, customers earn 2 stars for every \$1 they purchase, with 25 stars allowing them to customize their drinks for free, and 100 stars redeemable for a brewed hot or iced coffee.<sup>17</sup> Additionally, if customers do not make any purchases for a six-month period, their stars begin to expire, prompting them to visit more frequently. This gamified approach fosters customer engagement and loyalty. Importantly, the massive data collected through these interactions serves as invaluable insight for informed business decisions. Former CTO Gerri Martin-Flickinger highlighted in 2016 the significance of this data, stating, "With our 90 million transactions a week we know a lot about what people are buying, where they're buying, how they're buying, and if we combine this information with other data, like weather, promotions, inventory, insights into local events, we can actually deliver better-personalized service to other customers."<sup>18</sup> For example, when expanding its product lines in the grocery store, Starbucks derived from the data that 25% of customers do not add milk

<sup>12</sup> Chapter 9, Pour Your Heart Into It.

<sup>13</sup> Chapter 9, Pour Your Heart Into It.

<sup>14</sup> Chapter 22, Pour Your Heart Into It.

<sup>15</sup> Chapter 18, Pour Your Heart Into It.

<sup>16</sup> The World's Most Admired For More Than Two Decades. <https://one.starbucks.com/get-the-facts/starbucks-named-worlds-most-admired/>

<sup>17</sup> Starbucks Rewards. [https://www.starbucks.com/rewards?gad\\_source=1](https://www.starbucks.com/rewards?gad_source=1)

<sup>18</sup> How Starbucks Uses Data and Insights to Win Big. <https://techhq.com/2018/09/how-starbucks-uses-data-and-insights-to-win-big/#:~:text=%E2%80%9CWith%20our%2090%20million%20transactions,personalized%20service%20to%20other%20customers%20%E2%80%9D>

to their coffee ordered in-store. Therefore, the company launched a new line of black coffee without milk.<sup>19</sup>

- b. **Feedback between baristas and customers led to a personal connection with customers and the invention of popular products** - At Starbucks, the baristas take the time to understand each customer's coffee preferences. They ask if customers want their drink hot or cold and if customers prefer a specific type of espresso, such as a blond espresso or a doppio. They also inquire about the type of milk customers like for their latte. If customers are unsure about what they want, Starbucks baristas could suggest different combinations to help them with their orders. This personalized service makes Starbucks stand out among competitors where customers can explore and enjoy a wide range of coffee options.
  - c. Direct communication between store employees and customers played a crucial role in the feedback loop. For example, many customers expressed interest in iced blended coffee beverages, which offered by competitors, through interactions with baristas. Recognizing this rising demand, Starbucks developed one of its most famous offerings, the Frappuccino.
6. **Starbucks strategically selected high-traffic, prominent locations in both established and emerging markets to optimize and enhance marketing and brand awareness.** These locations include a range of settings such as office buildings, downtown and suburban retail centers, and kiosks in areas like building lobbies, airport terminals, and supermarket entrances. By leasing such prime spots, Starbucks aims to draw a consistent stream of customers while solidifying its brand presence. Furthermore, these prime locations sometimes facilitate the implementation of Starbucks' bold self-cannibalization strategy. A notable instance occurred in 2015 when Starbucks opened a new store just 30 yards away from an existing one on Wall Street. Despite initial concerns of a 10%-15% cannibalization rate, both stores thrived without any negative impact.<sup>20</sup> The bustling nature of Wall Street contributed to the success of both locations. From its IPO in 1992 until the onset of the Great Financial Crisis in 2008, Starbucks achieved 16 years of consecutive growth in comparable sales, even as 30% of its stores experienced self-cannibalization.<sup>21</sup>
7. **A bold culture of experimentation for the benefit of the customer.** Starbucks has a strong customer-centric ethos, with one of its mission statements being to “develop enthusiastically satisfied customers all of the time.”<sup>22</sup> It fosters an entrepreneurial atmosphere to encourage experimentation best for the customer. This is reflected in their product development process, which aligns with its commitment to satisfying customer needs, whether or not those requests directly translate into immediate sales. A notable example is Frappuccino. Customers began by asking if Starbucks offered an icy blended coffee drink as some competitors had on their menus. At the time, Starbucks didn't have such a product, leading some customers to go elsewhere to satisfy their craving for a blended coffee beverage. In response, Starbucks' store employees began experimenting with their own versions of an icy blended coffee drink. The initial experiments at the store level showed promise, prompting the company to officially roll out Frappuccino nationwide. It took less than five months to retrofit more than 550 stores with blenders and to train baristas on how to make the new drinks. In 1996, the first full year of Frappuccino's nationwide launch, Starbucks sold \$52 million worth of Frappuccino, representing about 7% of the company's total revenue for that year. Frappuccino has also become one of the signature products from Starbucks.
8. **Leveraging other brands to expand their own and increase awareness.**
- a. Starbucks forged partnerships with other companies to broaden its reach and increase awareness of Starbucks' existence. For instance, in 1991, when Starbucks ventured into licensing, it collaborated with Host Marriott for airport locations, aiming to expose travelers to its coffee and enhance global brand awareness. Subsequently, in 1996, Starbucks began serving its coffee on United Airlines flights, despite the notorious reputation of airline coffee. However, Starbucks ensured that United Airlines maintained its quality standards by providing thorough training to flight attendants on coffee knowledge, Starbucks' values, and its history, enabling them to address customer inquiries effectively. This partnership not only provided exposure to millions of passengers but also facilitated advertising opportunities in national magazines circulated by United Airlines, alongside an endorsement from one of the country's largest airlines. A survey conducted by Starbucks in 1996 indicated that about 14 percent of Starbucks customers had tasted their first Starbucks coffee on United. While some said the in-flight coffee was not quite as

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<sup>19</sup> The Perfect Blend: Starbucks and Data Analytics. <https://d3.harvard.edu/platform-digit/submission/the-perfect-blend-starbucks-and-data-analytics/>

<sup>20</sup> 5/28/2015, Starbucks Sanford C. Bernstein Strategic Decision Conference.

<sup>21</sup> 9/13/2022, Starbucks Investor Day.

<sup>22</sup> Chapter 9, Pour Your Heart Into It.

good as what they had bought at Starbucks stores, a large majority of passengers said that it was better than that of other airlines.

- b. Starbucks pursued expansion in new markets such as the international market through licensing agreements with local partners. For instance, when venturing into Japan in its first international market outside of the U.S. and Canada, Starbucks opted for a joint venture with a local company to develop retail stores. Similarly, in 1998, it signed licensing agreements with a local company to tap into the vast consumer base in China. These strategic moves targeted countries with substantial population sizes, positioning Starbucks for potential growth in these new markets.

**9. Management were large owners (18%) of the stock and Schultz (the CEO) owned ~9% of the company. Employees were incentivized by the benefit package and the employee stock ownership program.**

According to the Starbucks prospectus filed on June 26, 1992, Starbucks' directors and officers combined owned approximately 18.1% of the company's outstanding shares before the IPO, with an estimated 15.8% after the offering. Howard Schultz himself owned 1.11 million shares, or 9.7% of the total shares before the IPO, dropping to 8.7% after the offering.

Starbucks was the first major retailer in the U.S. to offer full health benefits to eligible full- and part-time employees. This comprehensive health coverage also extended to employees with terminal illnesses until they became eligible for government programs. Bean Stock, an employee stock ownership program, granted stock options to all employees from top managers to baristas, in proportion to their base pay. The initiative transformed Starbucks employees from being just "employees" to being "partners". This plan enabled employees to become stakeholders in the company, granting them ownership of a share of the business. As they continue to work and contribute to the growth of the company, they have the potential to increase their stake, fostering a sense of collective ownership and collaboration in building the business together.

Benefits and the stock ownership program not only helped Starbucks retain talent but also encouraged a culture where employees feel personally invested in the company's success.

**10. The valuation multiple was optically high (~80x P/E), but not when factoring in the trailing growth of 78% and the fact that it was now profitable starting FY1990. Within seven years that IPO multiple would be <4x P/E, driven by a revenue CAGR of 51% (comparable sales 9% CAGR, the number of stores over 50% CAGR from 126 stores in March 1992 to FY1999) and earnings having a CAGR of 59% over the period.**

When Starbucks went public in June 1992, its valuation seemed quite high at first blush, with a P/E ratio of nearly 80x based on its trailing twelve-months earnings. This would prove to be very cheap due to the rapid earnings growth of the company from opening stores, predominantly. Starbucks traded at 137x over its FY1992 earnings and declined to just 3.8x in FY1999, only 7 years after its IPO, driven by its rapid earnings growth that a CAGR of 82% over those 7 years.

While the stated LTM P/E at the time of Starbucks IPO was 76x, it is important to note that Starbucks only operated 126 locations and had an estimated market share of 2% in U.S. gourmet coffee in 1989. If one believed that Starbucks could achieve just 10% market share, which was about 5 times of its current market share in the US, and maintain its current net margins, the price to earnings ratio would be closer to 15.0x.

**Figure 2: Valuation Metrics**

Metric	Amount (\$ 000s)	Multiple / Ratio Analysis
Market Cap	\$ 235,618	-
Enterprise Value	\$ 225,485	3.1x EV/Sales; 5.6x EV/Gross Profit
Cash	\$ 13,503	5.73% of Market Cap
LTD, STD, & Current Portion of LTD	\$ 3,370	\$10.1M of Net Cash
-	-	-1.17x Net Debt/EBITDA
Working Capital (inc. Cash)	\$ 16,757	7.11% of Mkt Cap
Net Working Capital (ex Cash and STD)	\$ 6,624	2.81% of Mkt Cap
Total Equity Value	\$ 44,691	5.27x Price/Book Value
Tangible Book Value	\$ 44,691	5.27x Price/Tangible BV
Gross Profit	\$ 40,380	55.04% Gross Profit Margin
SG&A	\$ 5,893	8.03% SG&A/Revenue

EBITDA	\$	8,661	26.03x EV/EBITDA
Capex	\$	12,611	-57.08x EV/(EBITDA-CAPEX)
Net Income	\$	3,085	76.38x P/E
Levered FCF	\$	-10,418	-22.62x Price/Levered FCF
Unlevered FCF	\$	-20,103	-11.72x EV/Unlevered FCF
Owner's Earnings	\$	-20,310	-11.60x Price/OE
		-	-11.1x EV/OE
ROIC		5.1%	-
ROTCE		8.1%	-
1-Yr. Sales CAGR		66.9%	-
1-Yr. CAGR of Same Store Sales		15%	-
1-Yr. EPS CAGR		5,709%	Net income turned positive from (\$1.2) million in FY1989 to \$0.02 million in FY1990, and to \$0.9 million in FY1991.
3-Yr. Sales CAGR		78%	-
3-Yr. CAGR of Same Store Sales		19%	-
3-Yr. EPS CAGR		N/A	Net loss before FY1990
		-	-
Total Number of Stores		126	as of 3/29/1992, from 11 stores in FY1987 <sup>23</sup>
5-Yr. CAGR of Stores		72%	From FY1987 to March 1992

Notes:

- All values are from Starbucks prospectus processed on 6/25/1992. These figures were likely the last publicly available pre-IPO.
- The above metrics are TTM value derived from the company's Prospectus that includes half-year results as of 3/29/1992.
- The market cap date above is as of 6/26/1992, the date of the IPO. \$17 per share; \$0.27 split-adjusted.
- The number of shares outstanding after the IPO is estimated from Starbucks' Prospectus  
 $12,716,735 + 11,43,150 = 13,859,885$
- $EV = \text{market cap as of IPO} + \text{STD (as of 3/29/1992)} + \text{LTD (as of 3/29/1992)} - \text{Cash (as of 3/29/1992)}$
- The company claims in its prospectus processed on 6/25/1992 that it had 11 stores at the end of fiscal 1987. It claims that it had 17 stores at the end of fiscal 1987 in its 1994 annual report.
- ROIC is calculated as  $EBIT * \text{Effective Tax Rate} / (\text{Total Asset} - \text{Cash} - \text{Non-interest Bearing Current Liabilities} + \text{Operating Leases})$ . Operating leases are added to the calculation because they represent tangible assets essential for Starbucks' operations. Prior to 2019, operating leases were not required to be included on the Balance Sheet under US GAAP.
- Components of ROTCE are calculated as,  $TTM\ EBIT = (\$3,505 + 2,909 - \$1,409) = \$5,005$ ;  $\text{Current Asset (ex. Cash)} = \$24,538 - \$13,503 = \$11,035$ ;  $\text{Current Liabilities (ex. STD)} = \$7,781 - \$3,370 = \$4,411$ ;  $\text{NFA (inc. operating leases)} = \$27,027 + \$28,549 = \$55,576$ . Operating leases are added to the balance sheet because they represent tangible assets essential for Starbucks' operations. Prior to 2019, operating leases were not required to be included on the Balance Sheet under US GAAP.
- 1-Yr. sales CAGR is calculated based on FY1991 and FY1990 due to data availability.
- 1-Yr. EPS CAGR is high because Starbucks's net income just turned positive from negative \$1.2 million in FY1989 to positive \$0.017 million in FY1990, and grew to \$0.9 million in FY1991.
- 3-Yr. CAGR of Same Store Sales is derived from the same store sales growth of 23% in 1990 and 15% in 1991. The same store sales growth of 1989 is missing due to data availability.
- 3-Yr. EPS CAGR is not available because the company's had net losses pre-1990.
- Starbucks' closest comparable companies, Diedrich and Peet's, did not go public until 1996 and 2001, respectively.

## Company Overview

Starbucks traces its roots back to 1971 when Gerald (Jerry) Baldwin, Gordon Bowker, and Zev Siegl opened the first store in Seattle, Washington, with a focus on offering high-quality whole coffee beans. The company underwent significant transformation when it was acquired by Il Giornale Coffee Company in 1987, founded by Howard Schultz. Following the

<sup>23</sup> Starbucks Prospectus.

acquisition, the company embraced the Italian coffeehouse model and subsequently changed its name to Starbucks Corporation in January 1988.<sup>24</sup>

Since then, Starbucks has experienced exponential growth, expanding its presence to over 38,000 stores across more than 80 markets globally.<sup>25</sup> Over the years, the company's objective has evolved. Initially, in 1992, Starbucks aimed “to become the leading specialty coffee retailer in each of its target markets by establishing Starbucks as the premier specialty coffee brand, providing a superior level of customer service, and engendering a high degree of customer loyalty.”<sup>26</sup> By 2023, Starbucks had shifted its primary objective to “maintain Starbucks standing as one of the most recognized and respected brands in the world”.<sup>27</sup>

Starbucks buys and roasts premium coffee beans to sell in its stores, where it also crafts hand-made coffees and Italian-style espresso beverages, alongside a variety of teas and other drinks. The company offers a range of food items as well. Beyond its company-owned locations, Starbucks also licenses its brand to other channels, including licensed stores and manufacturers like Nestlé. Throughout its history, company-owned stores have consistently contributed more than 80% of Starbucks' total revenue.

Starbucks became the largest and most recognized coffeehouse chain not only by offering high-quality coffee and beverages but also through extensive customer education such as providing booklets and other materials in-store to introduce Starbucks' coffee beans from different regions and baristas trained to be knowledgeable about coffees, top-notch customer service, and innovative marketing. Although Howard Schultz mentioned in his memoir that Starbucks never aimed to build a brand, everything the company has done, from vertically controlling its supply chain and product development to customer education and cultivating strong employer-employee relationships, has served to establish and strengthen the Starbucks brand. This comprehensive approach has enabled Starbucks to create a unique identity and customer loyalty that extends far beyond just selling coffee.

When Starbucks (Il Giornale) was founded in 1985, the U.S. coffee market was experiencing a downturn. Although the U.S. had been the largest importer of coffee beans globally since the 1960s, **the per capita availability—a proxy for consumption—was nearly 40% lower than its peak in the 1940s<sup>28</sup> and continued to decline, as illustrated in Figure 3-1.**

Several factors contributed to the decline in coffee consumption. One significant reason was the increased availability of other beverages, especially soft drinks, which acted as substitutes for coffee, as shown in Figure 3-2. Additionally, the rising price of coffee beans during this period not only reduced coffee consumption but also prompted a shift in U.S. consumer tastes from much stronger brews in the 1940s to more diluted coffee,<sup>29</sup> including soluble and instant varieties. Many U.S. companies began providing instant coffee to meet this demand. Supermarkets also contributed to this trend by promoting budget prices on coffee and other staples, pressuring coffee companies to keep costs low to maintain profitability.<sup>30</sup> This focus on cost reduction often led to a decline in the quality of coffee available in the market.

From 1980 to 1992, the average urban household's coffee expenses as a percentage of household income decreased from 0.31% to 0.11%, as indicated in Figure 3-3. This decline correlates with the decreasing trend in daily coffee consumption. The relatively low proportion of income spent on coffee suggests that daily coffee consumption did not significantly strain household budgets. Consequently, households may have been less sensitive to changes in coffee prices, which could help explain the widespread adoption of coffee in American culture.

Despite this broader decline in coffee consumption, the sales of gourmet coffee<sup>31</sup> grew from \$208 million in 1983 to \$676 million in 1989 and were expected to grow at 9.3% annually to \$1.05 billion by 1994,<sup>32</sup> indicating a growing niche for higher-quality coffee and unique coffeehouse experiences. This increase in specialty coffee sales marked a shift in

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<sup>24</sup> Starbucks Prospectus; Starbucks Timeline: Il Giornale. <https://archive.starbucks.com/record/il-giornale>

<sup>25</sup> Starbucks Annual Report 2023, for the fiscal year ended 10/01/2023.

<sup>26</sup> Starbucks Prospectus.

<sup>27</sup> Starbucks Annual Report 2023, for the fiscal year ended 10/01/2023.

<sup>28</sup> Coffee Consumptions Over the Last Century. Economic Research Service, U.S. Department of Agriculture. <https://www.ers.usda.gov/amber-waves/2007/june/coffee-consumption-over-the-last-century/>

<sup>29</sup> Pg. 35, World Demand Prospects for Coffee in 1980. U.S. Department of Agriculture.

<sup>30</sup> Good News Not Enough To Perk Up Coffee Sales, October 16, 1990, Chicago Tribune.

<sup>31</sup> Also known as “specialty coffee”, include true gourmet coffee (arabica coffee sold in whole bean and ground form), premium coffee (upscale coffee mass marketed by leading coffee companies), and decaffeinated coffee. Starbucks Prospectus.

<sup>32</sup> Starbucks Prospectus.

consumer behavior, with a new segment of the market emerging that valued quality, craftsmanship, and the overall coffeehouse experience—factors that Starbucks would leverage to become a dominant force in the coffee industry.

In his book, *Pour You Heart into It*, Schultz recalled the first time he tried Starbucks coffee during his client visit in 1981:

*This was a time when most people thought coffee came from a can, not a bean...Even from a single sip, I could tell it was stronger than any coffee I had ever tasted... By comparison, I realized, the coffee I had been drinking was swill...Most of the coffee Americans drank was robusta, the inferior type that the coffee traders of London and Amsterdam treated as a cheap commodity.*

Figure 3-1: Per Capita Consumption in the U.S.<sup>33</sup>

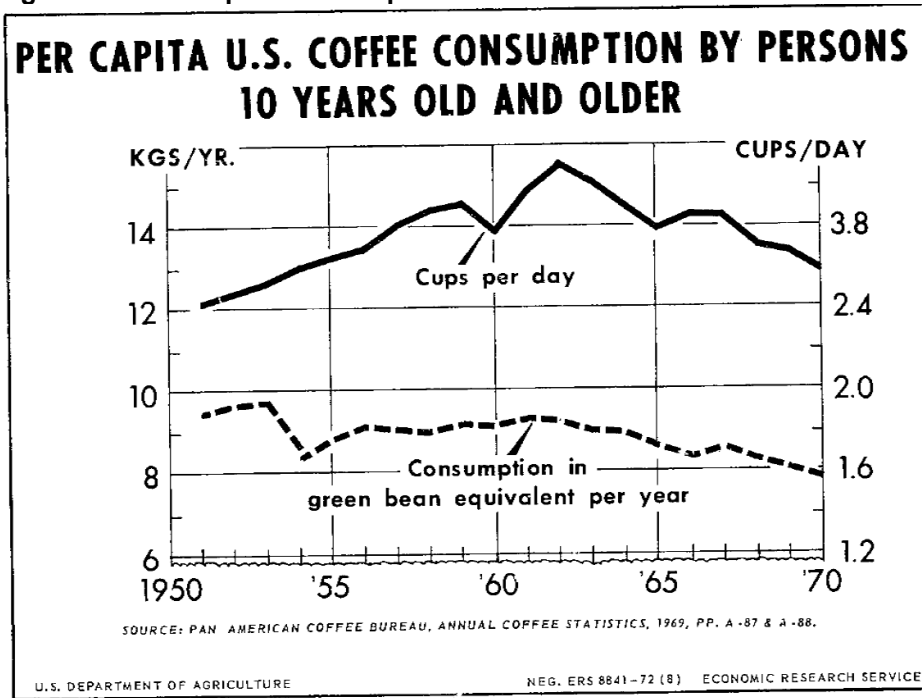
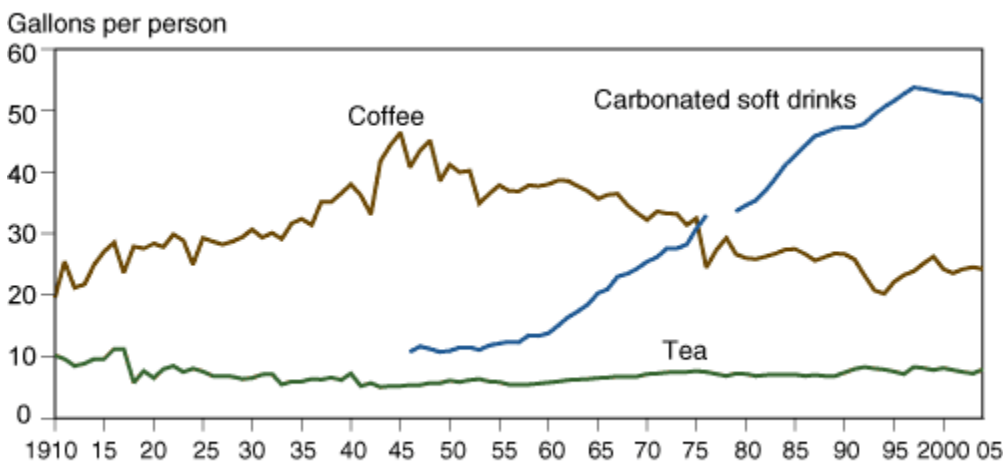


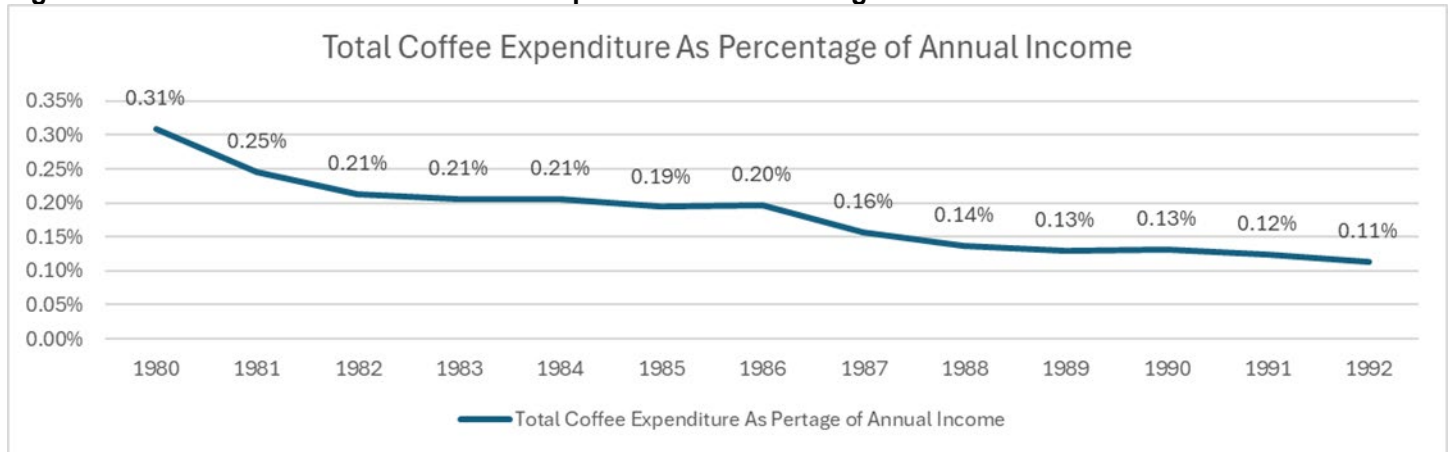
Figure 3-2: Per Capita Consumption in the U.S. Coffee availability in the United States peaked in 1946



Sources: USDA, Economic Research Service using data on carbonated soft drinks from the Bureau of the Census for 1947-77 and the Beverage Marketing Corporation for 1980-2005.

<sup>33</sup> Pg. 38, World Demand Prospects for Coffee in 1980. U.S. Department of Agriculture. Worldly Partners For Informational Purposes Only

**Figure 3-3: Total Urban Household Coffee Expenditure as Percentage of Urban Household Annual Income<sup>34</sup>**



	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Household Income Pre-Tax	\$ 17,843	\$ 19,235	\$ 21,086	\$ 22,140	\$ 23,547	\$ 25,103	\$ 26,053	\$ 27,795	\$ 28,929	\$ 31,291	\$ 33,152	\$ 32,936	\$ 33,764
Member Per Household	2.58	2.60	2.54	2.51	2.59	2.53	2.52	2.53	2.55	2.54	2.54	2.55	2.52
Annual Coffee Expenditure per Person	21.32	18.2	17.68	18.2	18.72	19.24	20.28	17.16	15.6	15.93	17.23	16.01	15.16
Total Coffee Expenditure Per Household	\$ 55	\$ 47	\$ 45	\$ 46	\$ 48	\$ 49	\$ 51	\$ 43	\$ 40	\$ 40	\$ 44	\$ 41	\$ 38
Total Coffee Exp. As Pertege of Annual Income	0.31%	0.25%	0.21%	0.21%	0.21%	0.19%	0.20%	0.16%	0.14%	0.13%	0.13%	0.12%	0.11%

**Notes:**

1. Percentage data are derived from the pre-tax household income, members per household, and annual coffee expenditure per person, provided on Food Spending in American Households 1980-92 by U.S. Economic Research Service, Washington, DC.

Although it's challenging to pinpoint the exact market size for premium coffees due to limited data, there are some indicators that suggest the quality of coffee declined during the mid-20th century. Since the mid-1950s, the share of green coffee beans (unroasted coffee beans) from Africa, which primarily produced robusta coffee, a type of coffee beans considered lower quality than arabica, increased steadily due to the rising demand for robusta beans from soluble coffee manufacturers.<sup>35</sup> **Between 1962 and 1970, Africa's share of the global coffee market increased from 20% to over 30%,<sup>36</sup> indicating that lower-quality robusta beans were gaining traction.**

This shift towards lower-quality coffee likely contributed to a decline in overall coffee quality, leading consumers to seek out higher-quality coffee options beyond supermarket brands. **This trend is reflected in the growth of the gourmet coffee segment, which rose from \$210 million in 1983 to an estimated \$675 million in 1989, accounting for over 10% of all coffee sales.** The gourmet coffee segment was the only part of the coffee market that continued to grow while the overall market was in decline.<sup>37</sup> Starbucks, with store sales of only \$16 million in 1989,<sup>38</sup> held an estimated 2% market share in the U.S. gourmet coffee market. The company's expectations for the growth of this segment were optimistic, forecasting that the gourmet coffee market would grow by 9% annually to \$1.05 billion by 1994, while the premium coffee market was expected to grow by 19% annually to \$681 million over the same period.<sup>39</sup> These figures highlight the potential for growth in the premium coffee sector, driven by a shift in consumer demand towards higher-quality coffee and a move away from the lower-quality robusta beans prevalent in soluble coffee. **Starbucks positioned itself within this growing segment, capitalizing on the consumer desire for gourmet coffee and paving the way for its transformation into a globally recognized coffeehouse chain.** In our discussion, Jerry Baldwin, one of the founders of Starbucks who later became the CEO and chairman of Peet's Coffee, remarked that the market for high-quality coffee in the U.S. during the 1980s was very small. He noted that there was no equipment available in the domestic market for making high-quality coffee drinks. Moreover, he also stated that specialty coffee did not become popular until Howard Schultz built and expanded Starbucks.<sup>40</sup>

<sup>34</sup> Food Spending in American Households 1980-92. U.S. Economic Research Service, Washington, DC.

<sup>35</sup> Pg. 8, World Demand Prospects for Coffee in 1980. U.S. Department of Agriculture.

<sup>36</sup> Table 10, World Demand Prospects for Coffee in 1980. U.S. Department of Agriculture.

<sup>37</sup> Boom in Fancy Coffee Pits Big Marketers, WSJ. 11/06/1989.

<sup>38</sup> Pg. 17, Starbucks Prospectus.

<sup>39</sup> Pg. 17, Starbucks Prospectus.

<sup>40</sup> Discussion Jerry Baldwin.

Coffee has long been part of the American culture, with a Department of Health study in 1980 revealing that over 80% of adults aged 20 and above were regular drinkers.<sup>41</sup> Beyond its mere consumption, coffee holds a symbolic significance, often seen as a marker of adulthood and a catalyst for social interaction. It is commonly seen at workplace, boardrooms, and social gatherings alike.

At the heart of coffee's popularity lies its addictive nature, primarily due to the presence of caffeine. This stimulant, naturally occurring in coffee, exerts a powerful influence on the body. As reported by The New York Times in 1982, caffeine acts to constrict vessels, accelerates heart rate, and stimulates various bodily functions such as heart and brain similar to amphetamines.<sup>42</sup> Dr. Stanford Miller, former director of the FDA's Bureau of Foods, described caffeine as a "potent biologically active material."<sup>43</sup>

Regular consumption of coffee often leads to both psychological and physical dependency, primarily driven by caffeine's effects. A moderate dose, typically ranging from 20mg to 200mg, can induce feelings of well-being, alertness, and sociability. However, the caffeine content in a cup of coffee can vary widely, ranging from 100mg to 200mg. Those reliant on caffeine may experience withdrawal symptoms upon cessation, including headaches, fatigue, and decreased alertness, as demonstrated by a study highlighting caffeine withdrawal after just three days of exposure.<sup>44</sup> **Consequently, for many professionals, coffee becomes an indispensable part of their daily routine, serving not only as a source of stimulation but also as a means to stave off withdrawal effects. This phenomenon potentially gained momentum post-war as urbanization surged, solidifying coffee's status as a social norm.**

### Investment Attributes at the Time of Investment

1. Is Starbucks a good company?

- a) Product and Marketing Strategy.
- b) Store operation strategy.
- c) Stored Value Cards.
- d) Expansion strategy.

Digging into each area:

#### **A. Product and Marketing Strategy**

In a market where coffee was often associated with low-quality instant coffees from big brands and supermarket shelves, **Starbucks set itself apart by offering superior quality, innovative products, and a unique in-store experience.** The company charged a premium for its products by emphasizing customer education, delivering an unmatched in-store ambiance, and placing its brand in prime locations with distinctive logos and storefronts. This strategy not only differentiated Starbucks from the broader coffee industry but also allowed it to stand out in the highly fragmented specialty coffee category, where none of its competitors were public companies before Starbucks. **It was estimated that there were about 500 smaller regional brands in the U.S. in this category before 2000, many of which were local coffee shops.**<sup>45</sup>

**Starbucks ensured the quality of its coffee by purchasing only arabica green beans directly from coffee-producing regions worldwide and roasting them in-house in small batches to maintain consistency and meet its high standards. According to the *World Demand Prospect For Coffee in 1980*, a research conducted by the U.S. Department of Agriculture, arabica beans have a softer and milder flavor, making them more appealing to consumers, unlike robusta beans, which are coarse and pungent, often used in lower-quality blends and instant coffee.**<sup>46</sup>

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<sup>41</sup> Coffee Drinking: An Emerging Social Problem? <https://www.jstor.org/stable/800387>

<sup>42</sup> The Caffeine Conflict – Where Does It Stand? [shttps://www.nytimes.com/1982/04/21/garden/the-caffeine-conflict-where-does-it-stand.html](https://www.nytimes.com/1982/04/21/garden/the-caffeine-conflict-where-does-it-stand.html).

<sup>43</sup> The Caffeine Conflict – Where Does It Stand? [shttps://www.nytimes.com/1982/04/21/garden/the-caffeine-conflict-where-does-it-stand.html](https://www.nytimes.com/1982/04/21/garden/the-caffeine-conflict-where-does-it-stand.html).

<sup>44</sup> Are We Dependent Upon Coffee and Caffeine? A Review On Human and Animal Data. <https://pubmed.ncbi.nlm.nih.gov/10073894/>

<sup>45</sup> Peet's Coffee Prospectus.

<sup>46</sup> Pg. 9, World Demand Prospects for Coffee in 1980. U.S. Department of Agriculture.

In the 1980s, as Starbucks entered a U.S. market accustomed to low-quality coffee from supermarkets made with robusta beans, the company faced the challenge of educating consumers about the benefits of paying a premium for higher-quality coffee and innovative drinks like lattes. **As Figure 4 shows, in 1992, while the average price of ground coffee per pound was \$2.58, Starbucks' whole-bean coffee ranged from \$6.75 to \$14.25 per pound, with an average of \$8.60 per pound, over 300% more expensive than the average price of ground coffee in the U.S.. This pricing reflected Starbucks' positioning as a premium brand.**

Starbucks' approach to customer education, high-quality products, and immersive in-store experiences played a significant role in transforming consumer perceptions of coffee and building a strong brand identity, or putting in the words of Howard Schultz, "Starbucks created an industry that did not exist."<sup>47</sup> By competing in a market where low-quality coffee was the norm, Starbucks established itself as a leader in the specialty coffee industry, attracting customers willing to pay a premium for a superior coffee experience. While an exact figure regarding the number of specialty coffee drinkers influenced by Starbucks' rise is unknown, Martin Diedrich, the founder of Diedrich Coffee and a competitor to Starbucks in California, stated that Starbucks grew people's awareness of specialty coffee.<sup>48</sup> Diedrich asserted that this heightened awareness contributed to an overall increase in the total number of specialty coffee drinkers. A survey in 1992 by the National Association of Specialty Food Trade showed that 31% of consumers bought specialty coffee in 1992, compared to 22% in 1990,<sup>49</sup> whereas 62% of consumers purchased commercial coffee in 1992, declined from 67% in 1990.

Jerry Baldwin emphasized the increasing trend of serving coffee beverages in-store since the 1980s.<sup>50</sup> For instance, during the 1984 Christmas season, shortly after Baldwin and his partners acquired Peet's (while still owning Starbucks), Peet's principal location on Vine Street in California sold about 5,000 pounds of coffee beans in-store per week. Baldwin observed that the demand for coffee beans in-store gradually declined, while the popularity of coffee drinks continued to rise. He stated that now Peet's sales of coffee beans in-store declined to around 600 pounds per week. Such data is not available for Starbucks.<sup>51</sup>

According to data from the U.S. Bureau of Labor Statistics in 1991, the average annual income for employees across 320 metropolitan areas was \$25,729.<sup>52</sup> In that same era, a cup of Starbucks coffee could be priced anywhere from \$0.65 to \$2.85 per cup. For someone who indulges in a daily cup of Starbucks coffee every morning throughout the year, this expenditure would equate to roughly 0.9% to 4% of the average annual salary. However, this expense wouldn't likely pose a significant financial strain, especially for individuals with higher incomes.

When considering whole bean coffee, Starbucks typically recommends using around 10 grams per serving.<sup>53</sup> With a pound of whole beans sold at an average price of \$8.60,<sup>54</sup> one can brew approximately 45 cups of coffee, or go through roughly 8 bags in a year. This expenditure, amounting to about 0.2% of annual income, again appears relatively modest in comparison.

While Starbucks strategically locates its stores in prime areas such as office buildings, downtown districts, and retail centers, Howard Schultz, in his memoir, articulated Starbucks' mission of offering an "affordable luxury," ensuring that everyone could treat themselves to something of exceptional quality.<sup>55</sup> Despite positioning itself as a premium coffeehouse, Starbucks boasts a diverse customer base, ranging from blue-collar workers like utility workers to affluent professionals such as surgeons.

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<sup>47</sup> Howard Schultz LinkedIn Post 5/5/2024. <https://www.linkedin.com/feed/update/urn:li:activity:7193044402255110144/>

<sup>48</sup> Discussion with Martin Diedrich.

<sup>49</sup> UNFILTERED ECSTASY SPECIALTY COFFEE CAFES, EMPORIUMS A RAPIDLY RISING 'SOCIAL PHENOMENON'. 7/24/1994.

<sup>50</sup> Discussion with Jerry Baldwin.

<sup>51</sup> Discussion with Jerry Baldwin.

<sup>52</sup> 1992 Annual Pay Levels in Metropolitan Areas.

[https://www.bls.gov/news.release/history/anpay2\\_101893.txt#:~:text=The%20U.S.%20average%20annual%20pay,nation%20averaged%20%2425%2C903%20in%201992.](https://www.bls.gov/news.release/history/anpay2_101893.txt#:~:text=The%20U.S.%20average%20annual%20pay,nation%20averaged%20%2425%2C903%20in%201992.)

<sup>53</sup> Starbucks Fact Sheet: Four Fundamentals of Brewing. <https://stories.starbucks.com/stories/2015/starbucks-tips-about-brewing-coffee-at-home/>

<sup>54</sup> Starbucks Prospectus.

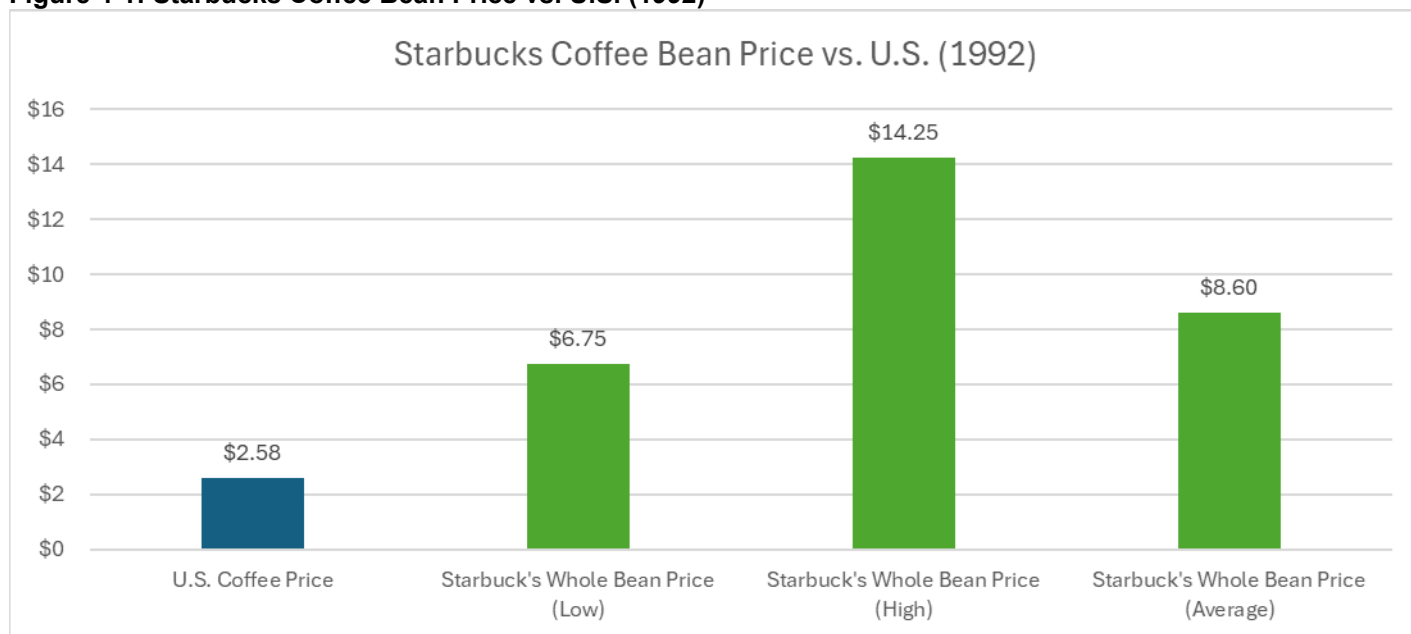
<sup>55</sup> Chapter 8, Pour Your Heart Into It.

“In our stores you may see a policeman or a utility worker standing in line in front of a wealthy surgeon. The blue-collar man may not be able to afford the Mercedes the surgeon just drove up in, but he can order the same \$2.00 cappuccino. They’re both giving themselves a reward and enjoying something world class.”<sup>56</sup>

In 1992, the average hourly wage for blue-collar and white-collar workers stood at approximately \$11.93 and \$15.27, respectively.<sup>57</sup> For a blue-collar worker, having a cup of Starbucks coffee during an 8-hour shift would amount to roughly 0.6% to 3% of their daily earnings. Similarly, for a white-collar worker, the expense would constitute about 0.5% to 2.3% of their daily wage. Notably, even for high-earning professionals like physicians, who could command an average annual salary exceeding \$177,000, the daily consumption of a cup of Starbucks coffee would only account for a minimal fraction, ranging from 0.1% to 0.5% of their income.<sup>58</sup>

Despite the lack of comprehensive data comparing each variety of coffee offered by Starbucks to its competitors within the same market, it is evident that Starbucks stands out as a formidable brand. As Figure 4-2 shows, a survey conducted in the Seattle market in 1992 revealed that Starbucks not only sold more coffee than any other brand but also commanded higher prices. In fact, Starbucks was the sole coffee company to surpass sales of 100,000 pounds of coffee, with an average price hovering around \$9 per pound. **The survey found that Starbucks sold its coffee at nearly \$9 per pound, while most other brands sold in a price range between \$2 and \$7. As a result, Starbucks is likely to maintain a high gross margin, expanding from 50% to over 60% throughout their history.** This underscores Starbucks' dominance and popularity within the coffee industry during that period.

**Figure 4-1: Starbucks Coffee Bean Price vs. U.S. (1992)<sup>59</sup>**



Note:

1. Because of limited data, the U.S. average U.S. coffee price is the ground roast.

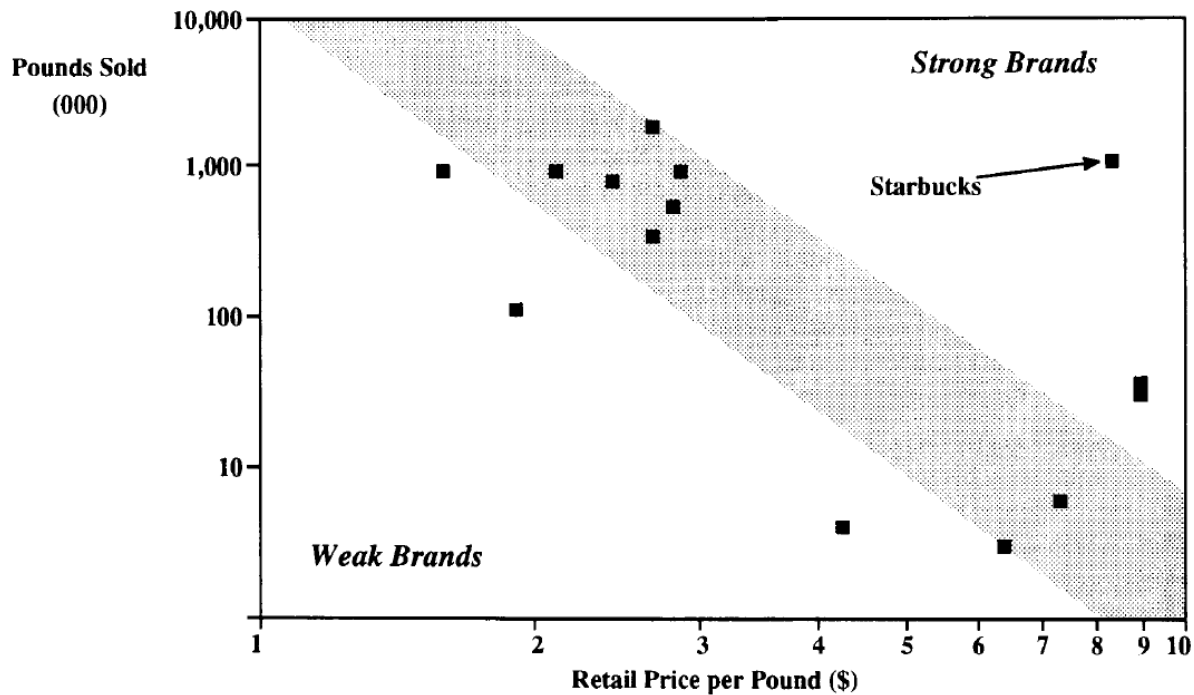
<sup>56</sup> Chapter 8, Pour Your Heart Into It.

<sup>57</sup> Blue-Collar Worker Profile and White-Collar Contrasts. <https://www.latimes.com/archives/la-xpm-1992-09-06-mn-247-story.html>

<sup>58</sup> Average doctor's pay for 1992: \$177,400. <https://www.tampabay.com/archive/1994/02/12/average-doctor-s-pay-for-1992-177400/#:~:text=All%20physicians%3A%20%24177%2C400%20average%2C%20%24148%2C000,Surgery%3A%20%24244%2C600%2C%20%24207%2C000.>

<sup>59</sup> U.S. Bureau of Labor Statistics: Annual Average for Coffee, 100%, ground roast, all sizes, per lb. (453.6 gm) in U.S. city average, average price, not seasonally adjusted. CPI Average Price Data. <https://www.usinflationcalculator.com/inflation/coffee-prices-by-year-and-adjust-for-inflation/>

Figure 4-2: Brand Strength Map: Coffee in 1992 Seattle Market  
**Brand Strength Map©: Coffee**  
 1992 Seattle market



Source: Infoscan, H&Q estimates  
 © Hambrecht & Quist, Inc. 1993 Brand Strength Map© is an H&Q trademark identifying a family of brand valuation charts.

Beyond justifying its higher prices with superior-quality coffee beans, Starbucks has been innovative in its product pipeline. For example, while many other coffee shops primarily offered brewed coffee, Starbucks was the first company to introduce caffè latte to the U.S., inspired by Howard Schultz's trip to Milan.<sup>60</sup> Starbucks also popularized other Italian espresso drinks, like macchiato. This pioneering approach to introducing Italian coffeehouse culture in the U.S. attracted customers and created a first-mover advantage. **When Howard Schultz opened the first Il Giornale store, it served over 300 customers on its opening day and received a lot of questions about the Italian-style espresso menu.**<sup>61</sup>

Customer education is a key element of Starbucks' merchandising strategy, aimed at leading customers to make purchases and ultimately turning them into repeat customers. Starbucks employees are trained to be knowledgeable about the quality aspects of coffee. The company requires a total of 24 hours of classroom training for each employee within the first six weeks of employment and on-the-job training focusing on coffee and equipment knowledge, customer service, sales skills, and beverage preparation.<sup>62</sup> Starbucks stores also provide booklets and other materials to help customers understand the differences between Starbucks' coffee blends and to highlight the unique qualities of the company's coffees compared to others. During his visits to Starbucks stores, Martin Diedrich frequently quizzed the baristas on their knowledge. He was always impressed by the Starbucks baristas' accurate answers, commending their depth of understanding about the nuances of coffee.<sup>63</sup>

Similarly, in the early days, when Peet's was still a small operation, the company followed rigorous procedures to ensure the quality of its coffee, as described by Jerry Baldwin in our discussion with him.<sup>64</sup> Roasters were trained to roast coffee beans in small batches, making adjustments for factors such as outside temperature and humidity that could influence the roasting process. Each batch of coffee was also cupped to understand any differences and ensure consistency in the final product. Additionally, Peet's baristas received extensive in-store training to ensure that every cup of coffee is good.

<sup>60</sup> Chapter 4, Pour Your Heart Into It, trip to Milan in 1983; A Dream 33 Years in the Making, Starbucks to Open in Italy, <https://stories.starbucks.com/stories/2016/howard-schultz-dream-fulfilled-starbucks-to-open-in-italy/>.

<sup>61</sup> Chapter 6, Pour Your Heart Into It.

<sup>62</sup> Starbucks Prospectus.

<sup>63</sup> Discussion with Martin Diedrich.

<sup>64</sup> Discussion with Jerry Baldwin.

Maintaining this level of training became more and more challenging as the company expanded and the number of stores opened increased.

Moreover, Starbucks' approach to opening coffeehouses instead of merely selling bagged coffee beans was not just about educating customers on fine coffee but also about showing them how to enjoy it. This holistic approach to customer experience—where employees are well-trained, and the environment is designed to encourage exploration and understanding—has been a critical factor in Starbucks' success. It not only differentiates Starbucks from other coffee shops but also reinforces the company's reputation as a provider of premium coffee experiences.<sup>65</sup>

To ensure quality in the taste of coffee served in-store and to support expansion to other locations, Starbucks has standardized the coffee roasting and brewing procedures for its different blends,<sup>66</sup> including strict controls on the weight of coffee beans per dose, grinding coarseness, water temperature, pressure, and brewing time. All espresso drinks must be made with the freshest beans. Coffee that isn't used within one hour of grinding must be discarded to maintain quality. Employees are responsible for ensuring the correct cup is used for each drink and that it's warmed, unless the drink is to-go or iced.

Quality control is a top priority. If any drink doesn't meet Starbucks' established standards, employees must prepare a new one and explain the reason to the customer. These protocols not only ensure a high level of quality across all Starbucks locations but also provide a framework for training employees. Moreover, these standards play a role in customer education. They help communicate Starbucks' commitment to quality and encourage customers to express their preferences when ordering. This customer-centric approach supports a consistent experience, builds trust, and strengthens the Starbucks brand.

*What we are serving is custom-by-the-cup. Take advantage of any opportunity to customize the drink to the customer ("Would you like the latte extra foamy?"). If the customer is dissatisfied with the product, offer to brew her/him another. Try to get them to describe specifically and in detail what they dislike about the drink. Explain our procedures and attempt to comply with their requests, if reasonable (NEVER ARGUE).<sup>67</sup>*

**When customers describe their coffee preferences to baristas at Starbucks, they not only receive a personalized drink but also discover the diverse range of coffee beverages the store offers and learn new ways to enjoy them.**

When a Starbucks barista assists customers with their coffee orders, they inquire about their preferences. They might ask whether the customer prefers their beverage hot or iced, whether they prefer blond espresso, a long shot, or a doppio. Additionally, they inquire about the type of milk desired for lattes. For customers unfamiliar with the various options, the barista provides suggestions to help them discover new combinations and enjoy their coffee experience. This interactive approach reinforces Starbucks' reputation as a sophisticated coffee brand and sets it apart from more conventional coffee shops.

In his book "*The Great Good Place*," Roy Oldenburg discusses the decline of "Third Places" in American society as urbanization has progressed. Third Places, which are neither home nor work, include spaces like local bars, coffee shops, and community centers. They play a critical role in fostering community and supporting civil society, providing informal environments where people can meet, interact, and relax without rigid schedules.

Starbucks has positioned itself as a modern Third Place, where people can gather, connect, and experience a sense of community. By encouraging customers to describe their preferences and engage in personalized coffee experiences, Starbucks contributes to the creation of these important social spaces, reinforcing its role in promoting social interaction and building a sense of community. When customers describe their coffee preferences, baristas find openings to start conversations. They might praise the customer's taste or propose different ways to enjoy their drink. Furthermore, individuals waiting in line or lingering in the store could initiate conversations with each other, whether discussing coffee choices or any other topics that come up during their day, making the place feel lively and friendly.

Starbucks stores also function as powerful brand billboards, promoting the company's image and values. As Schultz noted, **"Every Starbucks store is carefully designed to enhance the quality of everything the customers see, touch, hear, smell, or taste. All the sensory signals have to meet the same high standards. The artwork, the music, the aromas, the surfaces—all must align with the flavor of the coffee. Everything here is best in class."**<sup>68</sup>

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<sup>65</sup> Chapter 4, Pour Your Heart Into It.

<sup>66</sup> Starbucks Training Manual.

<sup>67</sup> Starbucks Training Manual.

<sup>68</sup> Chapter 18, Pour Your Heart Into It.

For example, the aroma of freshly brewed coffee fills the air, creating a rich and inviting atmosphere that even non-coffee drinkers find appealing. This sensory experience contributes to the Starbucks brand, making each visit memorable and engaging. Whether it's the design of the interior, the choice of music, or the quality of the coffee, every detail is crafted to deliver a cohesive and elevated experience.

The in-store soundscape at Starbucks is carefully crafted to enhance the brand's image and provide customers with a sense of sophistication, comfort, and class. The familiar hiss of the espresso machine, the rhythmic thud as baristas knock used coffee grounds from the filter, and the gentle steam of milk all contribute to the ambiance, underscoring Starbucks' commitment to making quality coffee. These sounds add to the experience, conveying the professionalism and expertise behind each cup.

The background music at Starbucks is just as thoughtfully selected, with a diverse range of genres including classical, jazz, opera, blues, and more.<sup>69</sup> This curated playlist not only sets the mood of being relaxed, casual, and lifted, but also becomes a talking point for customers.<sup>70</sup> In fact, Starbucks' music choices have been so popular that the company started selling CDs and collaborating with music companies to distribute the tracks played in-store. This move came after Starbucks went through two years' worth of customer comment cards in 1994 and found hundreds of requests asking where to buy the music played in stores.<sup>71</sup>

While the music sales represent a small fraction of Starbucks' overall revenue, this initiative demonstrates the company's commitment to meeting customer needs and enhancing satisfaction. By listening to customer feedback and responding with creative solutions, Starbucks strengthens customer loyalty and cements its reputation as a brand that truly cares about the details of the customer experience.

Starbucks employs an in-house design team to oversee the layout of its stores, from the choice of furniture to the selection of artwork. This team ensures that the design meets the same high standards as the coffee itself. Every element is carefully considered to be best-in-class, top-quality, and to convey a personality that is both sophisticated and approachable. Each store is designed to reflect the unique character of its neighborhood while maintaining a consistent look that identifies it as part of the Starbucks family.<sup>72</sup> To support its rapid growth, Starbucks has also standardized its design and purchasing processes. This approach allows the company to maintain a sense of sophistication and style across all its locations while providing a comfortable environment for casual interactions. **Using high-quality materials and fixtures, the stores project an upscale brand image, creating an experience that feels like "affordable luxury" to customers—encouraging them to return.** Starbucks introduced chairs and couches when it opened its first espresso bar in 1987, inviting customers to linger and socialize while enjoying their coffee. This setup has since evolved into the concept of a "Third Place," a space between home and work where people can gather, relax, and build community. The welcoming environment fosters a sense of romance and connection among customers; some even meet their significant others at Starbucks.

Overall, the thoughtful design and careful attention to detail help create an atmosphere where customers feel valued and at ease, which ultimately contributes to the enduring success of the Starbucks brand.

*Jim and Deb talked briefly every day (as in real-life conversation) at their local Starbucks in Calgary, Canada, quickly realizing they had a lot in common. After two years of dating, Deb proposed to Jim — at Starbucks — and in 2014, they got married there too.*<sup>73</sup>

Starbucks' reputation for high-quality coffee, exceptional customer service such as friendly and knowledgeable baristas who are willing to remake coffees for unsatisfied customers, and a welcoming atmosphere in its existing markets provides a solid foundation for expansion into new territories. The company's ability to create awareness and attract positive attention makes it easier to enter new markets, as customers often recognize Starbucks as a symbol of authentic coffee culture. Howard Schultz once reflected on this, saying:

*"Before we even opened our first store, the Los Angeles Times named us the best coffee in America."*<sup>74</sup>

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<sup>69</sup> Chapter 18, Pour Your Heart Into It.

<sup>70</sup> Chapter 15, Pour Your Heart Into It.

<sup>71</sup> Chapter 15, Pour Your Heart Into It.

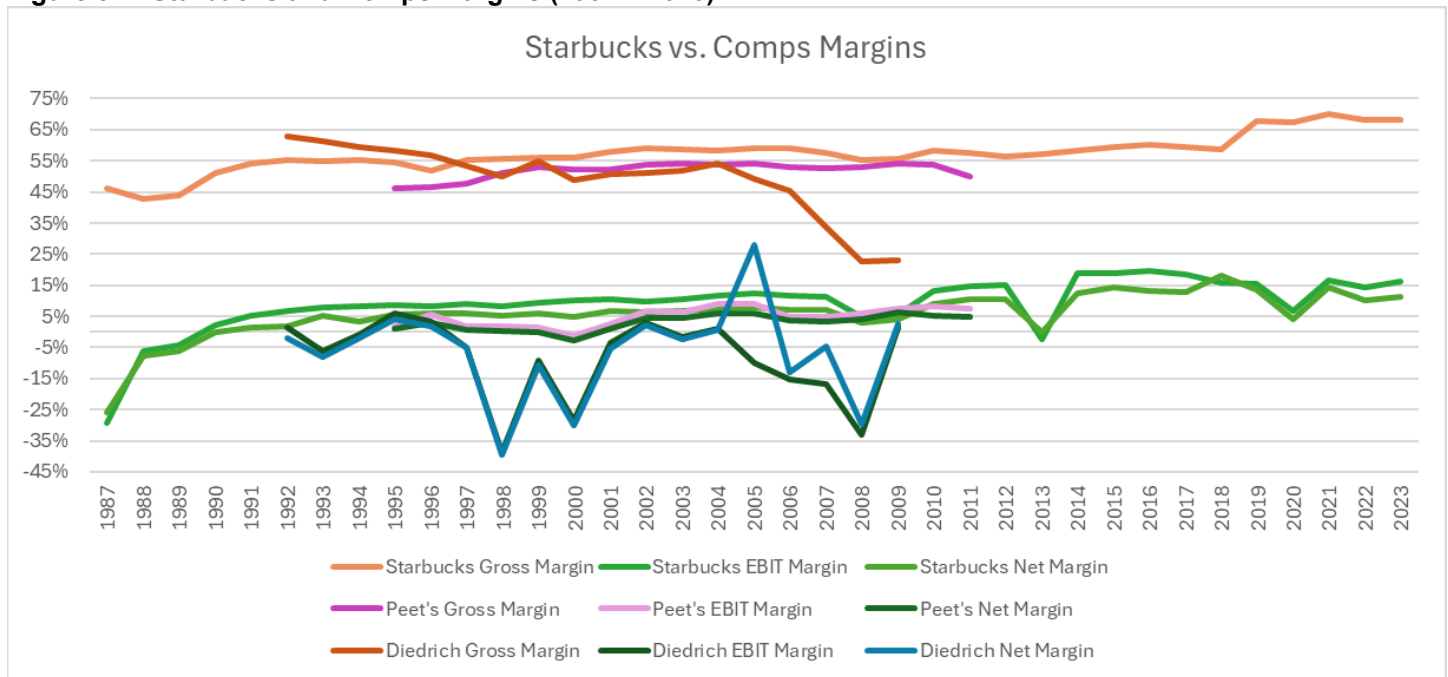
<sup>72</sup> Chapter 22, Pour Your Heart Into It.

<sup>73</sup> This Starbucks Love Story Will Make You Want to Find Your Soul Mate on Your Next Coffee Run. 1/24/2017. Cosmopolitan.

<sup>74</sup> Chapter 8, Pour Your Heart Into It.

Starbucks' superior quality, unparalleled customer service, and inviting atmosphere give it a competitive advantage to serve premium-priced coffee beverages in-store, rather than just selling bagged beans for customers to take home. As Figure 5-1 illustrates, Starbucks' gross margin has consistently grown over the years as the company has opened more locations serving coffee beverages.

**Figure 5-1: Starbucks and Comps Margins (1987 – 2023)**



Note:

1. Diedrich started in 2005 to either close or sell their retail stores to other companies such as Starbucks in the U.S., and Gloria Jean in the international markets, and other parties. The company wanted to focus on wholesale business.<sup>75</sup>

**Figure 5-2: Starbucks Margin Table (1995 – 2011)**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
<b>Starbucks Gross Margin</b>	54.6%	51.8%	55.3%	55.8%	55.9%	56.2%	58.0%	59.0%	58.6%
<b>Starbucks EBIT Margin</b>	8.6%	8.2%	9.1%	8.3%	9.3%	10.1%	10.6%	9.7%	10.4%
<b>Starbucks Net Margin</b>	5.6%	6.0%	5.9%	5.2%	6.1%	4.7%	6.8%	6.5%	6.6%
	2004	2005	2006	2007	2008	2009	2010	2011	
<b>Starbucks Gross Margin</b>	58.5%	59.1%	59.2%	57.5%	55.3%	55.8%	58.4%	57.7%	
<b>Starbucks EBIT Margin</b>	11.5%	12.3%	11.5%	11.2%	4.9%	5.7%	13.3%	14.8%	
<b>Starbucks Net Margin</b>	7.4%	7.8%	7.2%	7.1%	3.0%	4.0%	8.8%	10.6%	

**Figure 5-3: Peet's Margin Table (1995 – 2011)**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
<b>Peet's Gross Margin</b>	46.3%	46.4%	47.7%	51.0%	52.9%	52.3%	52.4%	53.7%	54.1%
<b>Peet's EBIT Margin</b>	1.7%	5.6%	1.9%	1.9%	1.3%	-1.1%	2.5%	6.6%	6.3%
<b>Peet's Net Margin</b>	1.1%	2.9%	0.7%	0.3%	-0.2%	-2.7%	1.2%	4.5%	4.3%

<sup>75</sup> Starbucks Buys Diedrich Stores. <https://www.globest.com/sites/globest/2006/09/17/starbucks-buys-diedrich-stores/?slreturn=20240401171333>

	2004	2005	2006	2007	2008	2009	2010	2011
<b>Peet's Gross Margin</b>	53.9%	54.1%	53.0%	52.5%	53.1%	54.1%	53.6%	49.9%
<b>Peet's EBIT Margin</b>	9.0%	9.0%	4.8%	4.7%	6.0%	7.5%	8.2%	7.4%
<b>Peet's Net Margin</b>	6.0%	6.1%	3.7%	3.4%	3.9%	6.2%	5.2%	4.8%

Note:

- Limited data on Peet's because it went public in 2001 and became private in 2012.

**Figure 5-4: Diedrich Margin Table (1995 – 2009)**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
<b>Diedrich Gross Margin</b>	58.3%	57.0%	53.2%	50.1%	54.8%	48.8%	50.6%	51.1%	52.0%
<b>Diedrich EBIT Margin</b>	6.0%	3.4%	-5.2%	-38.8%	-9.4%	-28.6%	-3.7%	3.0%	-1.7%
<b>Diedrich Net Margin</b>	4.3%	1.8%	-5.0%	-39.7%	-10.6%	-30.1%	-5.5%	2.0%	-2.2%

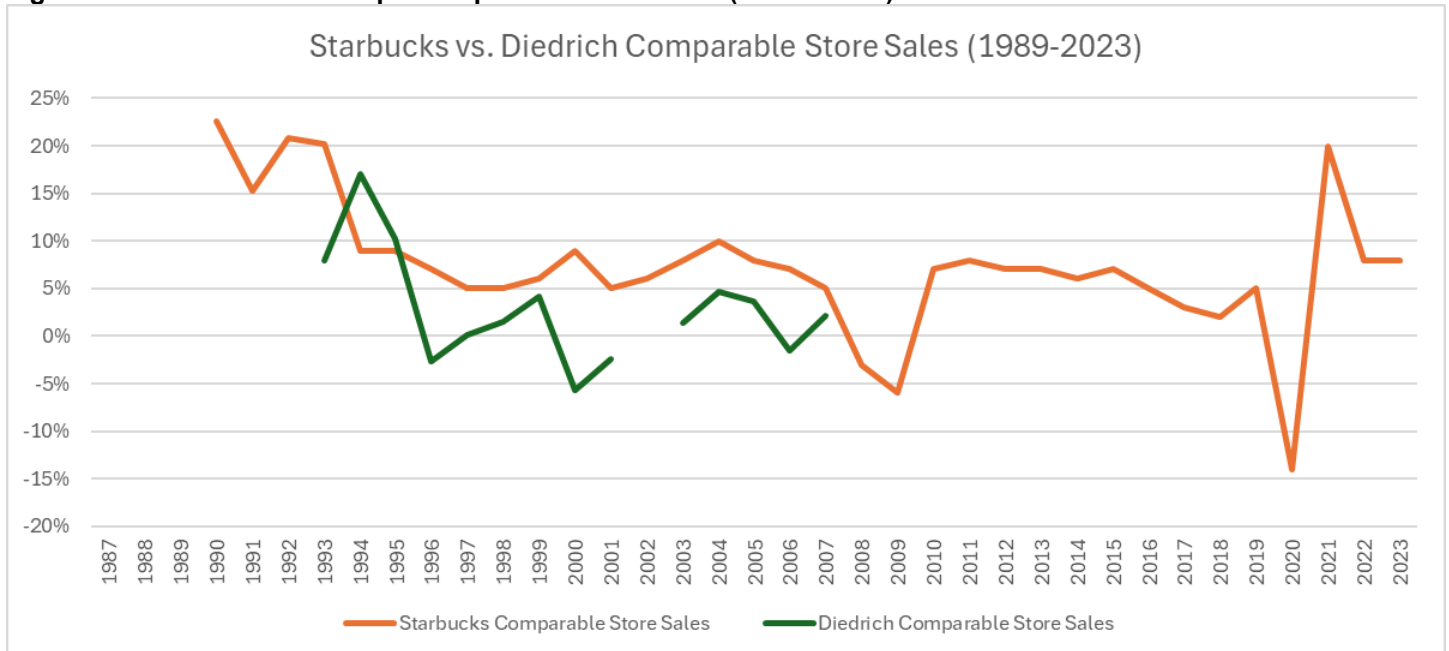
	2004	2005	2006	2007	2008	2009
<b>Diedrich Gross Margin</b>	54.0%	49.1%	45.4%	33.8%	22.6%	23.1%
<b>Diedrich EBIT Margin</b>	1.1%	-9.9%	-15.2%	-16.6%	-33.2%	1.5%
<b>Diedrich Net Margin</b>	0.5%	27.8%	-13.1%	-4.8%	-29.7%	2.6%

Note:

- Limited data on Diedrich because it went public in 1996 and acquired by Green Mountain Coffee Roasters in 2009.

With the growing market for specialty coffee, Starbucks has continued to grow organically for most of the years throughout its history (22% sales CAGR from FY1991 to FY2023, with an average growth rate of 6% on comparable store sales). The company has only seen 3 fiscal years with declines during its development, which were in 2008 and 2009 during the Great Financial Crisis and 2020 during the Global Pandemic, as shown in Figure 6. We do not have comparable data from Peet's because the company did not disclose it.

**Figure 6: Starbucks and Comps Comparable Store Sales (1989 – 2023)**



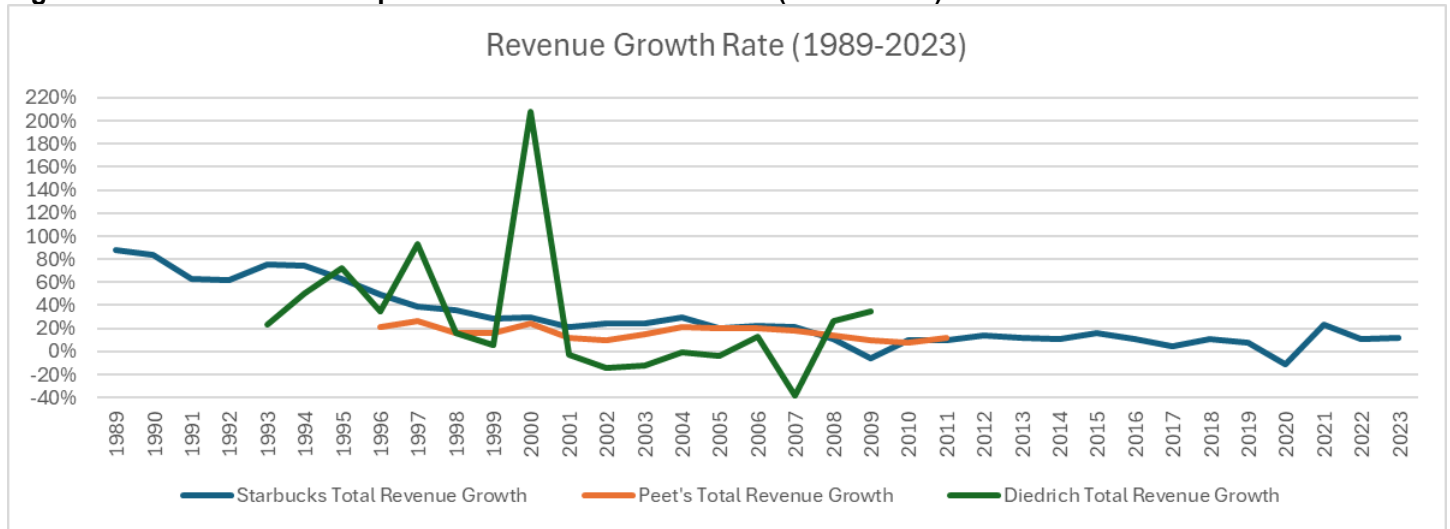
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
<b>Starbucks Comparable Store Sales</b>	23%	15%	21%	20%	9%	9%	7%	5%	5%	6%	9%	5%	6%	8%	10%	8%	7%
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Starbucks Comparable Store Sales</b>	5%	-3%	-6%	7%	8%	7%	7%	6%	7%	5%	3%	2%	5%	-14%	20%	8%	8%
	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007		
<b>Diedrich Comparable Store Sales</b>	8%	17%	10%	-3%	0%	2%	4%	-6%	-2%		1%	5%	4%	-2%	2%		

Notes:

- Peet's did not disclose its comparable store sales.

- Limited data on Diedrich because it went public in 1996 and acquired by Green Mountain Coffee Roasters in 2009.
- Declined comparable sales for Starbucks in 2008-2009, and 2020 were because of Great Financial Crisis and Global Pandemic, respectively.

**Figure 7: Starbucks and Comps Revenue Growth Rate Chart (1989 – 2023)**



**Note:**

- Limited data on Peet's because it went public in 2001 and became private in 2012.
- The significant revenue growth in 2000 for Diedrich was partly because of 1) the change in fiscal year end from January 27 in 1999 to June 28 in 2000; 2) the acquisition of Coffee People, and Gloria Jean.
- On 9/26/2006, Starbucks entered into an agreement with Diedrich to purchase its 40 of 47 company-operated retail locations under the Diedrich Coffee and Coffee People brands. The transfer was closed by locations throughout 2007.

Figure 8-1: Starbucks Common-Size Income Statement (1987 – 2023)

	1987	1988	1989	1990	1991	1992	1993	1994	1995
Company-operated stores	81.25%	78.84%	81.34%	84.69%	86.76%	87.09%	87.11%	87.21%	86.55%
Food service and other	18.75%	21.16%	18.66%	15.31%	13.24%	12.91%	12.89%	12.79%	13.45%
Licensing	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total specialty	18.75%	21.16%	18.66%	15.31%	13.24%	12.91%	12.89%	12.79%	13.45%
<b>Total net revenues</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>
Cost of goods and services sold	53.82%	57.12%	56.22%	48.88%	45.83%	44.61%	45.00%	44.67%	45.42%
<b>Gross Margin</b>	<b>46.18%</b>	<b>42.88%</b>	<b>43.78%</b>	<b>51.12%</b>	<b>54.17%</b>	<b>55.39%</b>	<b>55.00%</b>	<b>55.33%</b>	<b>54.58%</b>
Store operating expenses	26.24%	26.42%	27.18%	29.72%	33.62%	33.56%	32.58%	32.69%	31.98%
Depreciation and amortization expenses	7.49%	5.79%	5.14%	4.27%	4.40%	3.91%	3.78%	4.40%	4.83%
Other operating expenses	1.58%	3.61%	3.46%	3.20%	2.57%	2.41%	3.07%	3.05%	2.99%
General and administrative expenses	40.11%	13.24%	12.35%	11.65%	8.54%	8.66%	7.63%	7.01%	6.16%
Other Expenses (Income)	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
<b>Total operating expenses</b>	<b>129.24%</b>	<b>106.18%</b>	<b>104.34%</b>	<b>97.72%</b>	<b>94.95%</b>	<b>93.16%</b>	<b>92.06%</b>	<b>91.82%</b>	<b>91.38%</b>
Gain on sale of properties	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Income from equity investees / JV income	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
<b>Operating income</b>	<b>-29.24%</b>	<b>-6.18%</b>	<b>-4.34%</b>	<b>2.28%</b>	<b>5.05%</b>	<b>6.84%</b>	<b>7.94%</b>	<b>8.18%</b>	<b>8.62%</b>
Gain / loss resulting from acquisition/divestiture/investment	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	-1.36%	0.00%
Net Interest & other	3.23%	-1.32%	-1.78%	0.02%	-0.04%	0.22%	0.58%	-0.59%	0.65%
<b>Earnings before income taxes</b>	<b>-26.00%</b>	<b>-7.50%</b>	<b>-6.12%</b>	<b>2.29%</b>	<b>5.01%</b>	<b>7.07%</b>	<b>8.51%</b>	<b>6.23%</b>	<b>9.27%</b>
Income taxes	0.00%	0.00%	0.00%	0.00%	0.83%	2.66%	3.31%	2.65%	3.66%
<b>Net earnings including noncontrolling interest</b>	<b>-26.00%</b>	<b>-7.50%</b>	<b>-6.12%</b>	<b>2.29%</b>	<b>4.18%</b>	<b>4.41%</b>	<b>5.20%</b>	<b>3.58%</b>	<b>5.61%</b>
Cumulative effect of accounting change for FIN 47, net of taxes	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
<b>Net earnings / loss attributable to noncontrolling interest</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>2.25%</b>	<b>2.61%</b>	<b>2.76%</b>	<b>0.00%</b>	<b>0.09%</b>	<b>0.00%</b>
<b>Net earnings / loss attributable to Starbucks</b>	<b>-26.00%</b>	<b>-7.50%</b>	<b>-6.12%</b>	<b>0.05%</b>	<b>1.57%</b>	<b>1.65%</b>	<b>5.20%</b>	<b>3.49%</b>	<b>5.61%</b>
	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Company-operated stores	86.16%	85.64%	84.25%	84.72%	83.74%	84.17%	84.92%	84.64%	84.19%
Food service and other	13.84%	14.36%	15.75%	15.28%	7.56%	6.75%	5.60%	5.31%	5.12%
Licensing	0.00%	0.00%	0.00%	0.00%	8.70%	9.09%	9.48%	10.05%	10.69%
Total specialty	13.84%	14.36%	15.75%	15.28%	16.26%	15.83%	15.08%	15.36%	15.81%
<b>Total net revenues</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>
Cost of goods and services sold	48.21%	44.70%	44.20%	44.10%	43.79%	42.01%	41.05%	41.37%	41.53%
<b>Gross Margin</b>	<b>51.79%</b>	<b>55.30%</b>	<b>55.80%</b>	<b>55.90%</b>	<b>56.21%</b>	<b>57.99%</b>	<b>58.95%</b>	<b>58.63%</b>	<b>58.47%</b>
Store operating expenses	30.25%	31.97%	31.98%	32.35%	32.37%	33.05%	34.09%	33.85%	33.81%
Depreciation and amortization expenses	5.16%	5.39%	5.54%	5.82%	5.98%	6.17%	6.25%	5.84%	5.29%
Other operating expenses	2.84%	2.91%	3.32%	3.06%	3.60%	3.52%	3.87%	3.47%	3.24%
General and administrative expenses	5.35%	5.91%	5.93%	5.34%	5.06%	5.72%	6.15%	6.00%	5.75%
Other Expenses (Income)	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
<b>Total operating expenses</b>	<b>91.82%</b>	<b>90.88%</b>	<b>90.97%</b>	<b>90.67%</b>	<b>90.80%</b>	<b>90.47%</b>	<b>91.40%</b>	<b>90.52%</b>	<b>89.62%</b>
Gain on sale of properties	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Income from equity investees / JV income	0.00%	0.00%	0.00%	0.00%	0.93%	1.08%	1.09%	0.94%	1.15%
<b>Operating income</b>	<b>8.18%</b>	<b>9.12%</b>	<b>9.03%</b>	<b>9.33%</b>	<b>10.13%</b>	<b>10.61%</b>	<b>9.69%</b>	<b>10.42%</b>	<b>11.52%</b>
Gain / loss resulting from acquisition/divestiture/investment	1.32%	0.00%	0.00%	0.00%	-2.70%	-0.11%	0.41%	0.00%	0.00%
Net Interest & other	0.33%	0.53%	0.55%	0.44%	0.33%	0.41%	0.28%	0.29%	0.27%
<b>Earnings before income taxes</b>	<b>9.84%</b>	<b>9.65%</b>	<b>9.57%</b>	<b>9.76%</b>	<b>7.76%</b>	<b>10.91%</b>	<b>10.38%</b>	<b>10.71%</b>	<b>11.79%</b>
Income taxes	3.79%	3.72%	3.67%	3.71%	3.03%	4.07%	3.84%	4.12%	4.39%
<b>Net earnings including noncontrolling interest</b>	<b>6.05%</b>	<b>5.94%</b>	<b>5.91%</b>	<b>6.05%</b>	<b>4.73%</b>	<b>6.84%</b>	<b>6.54%</b>	<b>6.58%</b>	<b>7.40%</b>
Cumulative effect of accounting change for FIN 47, net of taxes	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
<b>Net earnings / loss attributable to noncontrolling interest</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>
<b>Net earnings / loss attributable to Starbucks</b>	<b>6.05%</b>	<b>5.94%</b>	<b>5.91%</b>	<b>6.05%</b>	<b>4.73%</b>	<b>6.84%</b>	<b>6.54%</b>	<b>6.58%</b>	<b>7.40%</b>

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
<b>Company-operated stores</b>	84.65%	84.54%	84.98%	84.48%	83.69%	83.71%	82.33%	79.21%	79.19%	78.90%
Food service and other	4.78%	4.41%	4.11%	4.23%	3.81%	3.76%	9.06%	11.69%	11.67%	11.44%
Licensing	10.57%	11.05%	10.91%	11.28%	12.50%	12.52%	8.61%	9.10%	9.14%	9.66%
<b>Total specialty</b>	<b>15.35%</b>	<b>15.46%</b>	<b>15.02%</b>	<b>15.52%</b>	<b>16.31%</b>	<b>16.29%</b>	<b>17.67%</b>	<b>20.79%</b>	<b>20.81%</b>	<b>21.10%</b>
<b>Total net revenues</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>
<b>Cost of goods and services sold</b>	<b>40.90%</b>	<b>40.82%</b>	<b>42.49%</b>	<b>44.74%</b>	<b>44.25%</b>	<b>41.64%</b>	<b>42.30%</b>	<b>43.71%</b>	<b>42.86%</b>	<b>41.70%</b>
<b>Gross Margin</b>	<b>59.10%</b>	<b>59.18%</b>	<b>57.51%</b>	<b>55.26%</b>	<b>55.75%</b>	<b>58.36%</b>	<b>57.70%</b>	<b>56.29%</b>	<b>57.14%</b>	<b>58.30%</b>
<b>Store operating expenses</b>	<b>34.01%</b>	<b>34.52%</b>	<b>34.17%</b>	<b>36.07%</b>	<b>35.04%</b>	<b>33.17%</b>	<b>31.32%</b>	<b>29.46%</b>	<b>28.78%</b>	<b>28.20%</b>
Depreciation and amortization expenses	5.34%	4.97%	4.96%	5.29%	5.47%	4.77%	4.47%	4.14%	4.17%	4.31%
Other operating expenses	3.09%	3.34%	3.13%	3.18%	2.70%	2.74%	3.44%	3.23%	3.07%	2.78%
General and administrative expenses	5.61%	6.07%	5.20%	4.39%	4.63%	5.32%	5.44%	6.02%	6.30%	6.03%
Other Expenses (Income)	0.00%	0.00%	0.00%	2.57%	3.40%	0.49%	0.00%	0.00%	18.70%	-0.12%
<b>Total operating expenses</b>	<b>88.95%</b>	<b>89.73%</b>	<b>89.95%</b>	<b>96.24%</b>	<b>95.50%</b>	<b>88.13%</b>	<b>86.97%</b>	<b>86.57%</b>	<b>103.87%</b>	<b>82.90%</b>
Gain on sale of properties	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.26%	0.00%	0.00%	0.00%
Income from equity investees / JV income	1.20%	1.21%	1.15%	1.09%	1.25%	1.38%	1.48%	1.58%	1.69%	1.63%
<b>Operating income</b>	<b>12.26%</b>	<b>11.48%</b>	<b>11.20%</b>	<b>4.85%</b>	<b>5.75%</b>	<b>13.26%</b>	<b>14.77%</b>	<b>15.02%</b>	<b>-2.19%</b>	<b>18.73%</b>
Gain / loss resulting from acquisition/divestiture/investment	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Net Interest & other	0.25%	0.16%	0.03%	-0.43%	-0.03%	0.16%	0.71%	0.46%	0.64%	0.48%
<b>Earnings before income taxes</b>	<b>12.50%</b>	<b>11.64%</b>	<b>11.22%</b>	<b>4.43%</b>	<b>5.72%</b>	<b>13.42%</b>	<b>15.48%</b>	<b>15.48%</b>	<b>-1.54%</b>	<b>19.21%</b>
Income taxes	4.74%	4.17%	4.08%	1.39%	1.72%	4.56%	4.81%	5.07%	-1.60%	6.64%
<b>Net earnings including noncontrolling interest</b>	<b>7.76%</b>	<b>7.47%</b>	<b>7.15%</b>	<b>3.04%</b>	<b>4.00%</b>	<b>8.86%</b>	<b>10.67%</b>	<b>10.41%</b>	<b>0.06%</b>	<b>12.57%</b>
Cumulative effect of accounting change for FIN 47, net of taxes	0.00%	0.22%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
<b>Net earnings / loss attributable to noncontrolling interest</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.03%</b>	<b>0.02%</b>	<b>0.01%</b>	<b>0.00%</b>	<b>0.00%</b>
<b>Net earnings / loss attributable to Starbucks</b>	<b>7.76%</b>	<b>7.25%</b>	<b>7.15%</b>	<b>3.04%</b>	<b>4.00%</b>	<b>8.83%</b>	<b>10.65%</b>	<b>10.40%</b>	<b>0.06%</b>	<b>12.57%</b>
	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	
<b>Company-operated stores</b>	79.31%	79.02%	78.84%	79.65%	81.27%	81.49%	84.67%	82.41%	81.90%	
Food service and other	10.98%	10.87%	10.64%	9.62%	7.88%	8.62%	6.09%	6.26%	5.56%	
Licensing	9.72%	10.11%	10.52%	10.73%	10.85%	9.89%	9.23%	11.33%	12.54%	
<b>Total specialty</b>	<b>20.69%</b>	<b>20.98%</b>	<b>21.16%</b>	<b>20.35%</b>	<b>18.73%</b>	<b>18.51%</b>	<b>15.33%</b>	<b>17.59%</b>	<b>18.10%</b>	
<b>Total net revenues</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	
<b>Cost of goods and services sold</b>	<b>40.64%</b>	<b>39.93%</b>	<b>40.37%</b>	<b>41.16%</b>	<b>32.17%</b>	<b>32.72%</b>	<b>30.07%</b>	<b>31.99%</b>	<b>31.71%</b>	
<b>Gross Margin</b>	<b>59.36%</b>	<b>60.07%</b>	<b>59.63%</b>	<b>58.84%</b>	<b>67.83%</b>	<b>67.28%</b>	<b>69.93%</b>	<b>68.01%</b>	<b>68.29%</b>	
<b>Store operating expenses</b>	<b>28.24%</b>	<b>28.45%</b>	<b>29.01%</b>	<b>29.10%</b>	<b>39.59%</b>	<b>45.77%</b>	<b>41.06%</b>	<b>42.05%</b>	<b>40.92%</b>	
Depreciation and amortization expenses	4.66%	4.60%	4.52%	5.04%	5.20%	6.09%	4.96%	4.49%	3.79%	
Other operating expenses	2.73%	2.56%	2.47%	2.18%	1.40%	1.83%	1.24%	1.43%	1.50%	
General and administrative expenses	6.24%	6.38%	6.22%	7.12%	6.88%	7.14%	6.65%	6.30%	6.79%	
Other Expenses (Income)	0.00%	0.00%	0.69%	0.91%	0.51%	1.19%	0.59%	0.14%	0.06%	
<b>Total operating expenses</b>	<b>82.51%</b>	<b>81.92%</b>	<b>83.28%</b>	<b>85.51%</b>	<b>85.74%</b>	<b>94.73%</b>	<b>84.56%</b>	<b>86.41%</b>	<b>84.76%</b>	
Gain on sale of properties	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.25%	
Income from equity investees / JV income	1.30%	1.49%	1.75%	1.22%	1.12%	1.37%	1.33%	0.73%	0.83%	
<b>Operating income</b>	<b>18.79%</b>	<b>19.57%</b>	<b>18.47%</b>	<b>15.71%</b>	<b>15.38%</b>	<b>6.64%</b>	<b>16.77%</b>	<b>14.32%</b>	<b>16.32%</b>	
Gain / loss resulting from acquisition/divestiture/investment	1.72%	0.00%	0.00%	7.59%	2.35%	0.00%	2.97%	0.00%	0.00%	
Net Interest & other	-0.14%	0.13%	0.82%	0.09%	-0.88%	-1.69%	-1.31%	-1.20%	-1.30%	
<b>Earnings before income taxes</b>	<b>20.37%</b>	<b>19.70%</b>	<b>19.29%</b>	<b>23.38%</b>	<b>16.85%</b>	<b>4.95%</b>	<b>18.43%</b>	<b>13.12%</b>	<b>15.02%</b>	
Income taxes	5.97%	6.47%	6.40%	5.11%	3.29%	1.02%	3.98%	2.94%	3.55%	
<b>Net earnings including noncontrolling interest</b>	<b>14.40%</b>	<b>13.22%</b>	<b>12.89%</b>	<b>18.28%</b>	<b>13.56%</b>	<b>3.93%</b>	<b>14.45%</b>	<b>10.18%</b>	<b>11.47%</b>	
Cumulative effect of accounting change for FIN 47, net of taxes	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	
<b>Net earnings / loss attributable to noncontrolling interest</b>	<b>0.01%</b>	<b>0.01%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>-0.02%</b>	<b>-0.02%</b>	<b>0.00%</b>	<b>0.01%</b>	<b>0.00%</b>	
<b>Net earnings / loss attributable to Starbucks</b>	<b>14.39%</b>	<b>13.22%</b>	<b>12.89%</b>	<b>18.28%</b>	<b>13.58%</b>	<b>3.95%</b>	<b>14.45%</b>	<b>10.18%</b>	<b>11.46%</b>	

Note:

1. 1995 data are extracted from Starbucks' FY1996 annual report.

Figure 8-2: Peet's Common-Size Income Statement (1995 – 2011)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Retail Stores	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	75.24%	71.58%
Specialty Sales	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	24.76%	28.42%
<b>Sales</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>
Cost of Sales and Related Occupancy Expenses	53.74%	53.63%	52.29%	48.99%	47.08%	47.68%	47.60%	46.26%	45.87%
<b>Gross Profit</b>	<b>46.26%</b>	<b>46.37%</b>	<b>47.71%</b>	<b>51.01%</b>	<b>52.92%</b>	<b>52.32%</b>	<b>52.40%</b>	<b>53.74%</b>	<b>54.13%</b>
Operating Expenses	25.70%	28.02%	29.11%	30.62%	32.30%	32.95%	32.24%	31.92%	32.34%
Depreciation & Amortization Expense	4.77%	4.46%	4.36%	4.62%	5.02%	5.43%	5.34%	4.39%	4.08%
Marketing and Advertising Expenses	2.16%	2.02%	4.49%	3.71%	5.15%	7.20%	5.10%	4.37%	3.78%
G&A Expenses	11.95%	6.28%	7.81%	10.16%	9.19%	7.89%	7.25%	6.47%	7.67%
Transaction Expense (Income), Net	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Litigation Related Expenses	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
<b>EBIT (Operating Income)</b>	<b>1.68%</b>	<b>5.59%</b>	<b>1.94%</b>	<b>1.91%</b>	<b>1.26%</b>	<b>-1.14%</b>	<b>2.47%</b>	<b>6.58%</b>	<b>6.26%</b>
Interest Expense (Income), Net	0.98%	0.61%	0.78%	1.21%	1.45%	2.26%	0.45%	-0.52%	-0.97%
Other Income	0.00%	0.00%	-0.18%	-0.10%	-0.05%	0.00%	0.00%	0.00%	0.00%
<b>Pretax Income</b>	<b>0.70%</b>	<b>4.98%</b>	<b>1.16%</b>	<b>0.70%</b>	<b>-0.19%</b>	<b>3.41%</b>	<b>2.02%</b>	<b>7.10%</b>	<b>7.23%</b>
Income Taxes (benefit)	-0.39%	2.12%	0.49%	0.41%	0.24%	-0.71%	0.79%	2.63%	2.91%
<b>Net Income</b>	<b>1.09%</b>	<b>2.86%</b>	<b>0.67%</b>	<b>0.29%</b>	<b>-0.21%</b>	<b>-2.70%</b>	<b>1.22%</b>	<b>4.47%</b>	<b>4.32%</b>
<b>Net Income available to Common</b>	<b>1.09%</b>	<b>2.86%</b>	<b>0.67%</b>	<b>0.29%</b>	<b>-0.21%</b>	<b>-2.70%</b>	<b>1.22%</b>	<b>4.47%</b>	<b>4.32%</b>
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	
Retail Stores	68.95%	67.37%	67.16%	67.52%	65.91%	64.62%	61.45%	57.61%	
Specialty Sales	31.05%	32.63%	32.84%	32.48%	34.09%	35.38%	38.55%	42.39%	
<b>Sales</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	
Cost of Sales and Related Occupancy Expenses	46.12%	45.88%	47.00%	47.47%	46.88%	45.87%	46.40%	50.11%	
<b>Gross Profit</b>	<b>53.88%</b>	<b>54.12%</b>	<b>53.00%</b>	<b>52.53%</b>	<b>53.12%</b>	<b>54.13%</b>	<b>53.60%</b>	<b>49.89%</b>	
Operating Expenses	33.31%	33.71%	34.33%	34.40%	34.70%	34.26%	32.85%	30.44%	
Depreciation & Amortization Expense	3.98%	4.17%	4.09%	4.38%	4.54%	4.87%	4.72%	4.19%	
Marketing and Advertising Expenses	2.59%	2.29%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	
G&A Expenses	4.98%	5.00%	9.80%	9.10%	7.91%	7.87%	7.52%	6.96%	
Transaction Expense (Income), Net	0.00%	0.00%	0.00%	0.00%	0.00%	-1.34%	0.29%	0.00%	
Litigation Related Expenses	0.00%	0.00%	0.00%	0.00%	0.00%	0.95%	-0.03%	0.88%	
<b>EBIT (Operating Income)</b>	<b>9.01%</b>	<b>8.96%</b>	<b>4.77%</b>	<b>4.65%</b>	<b>5.97%</b>	<b>7.52%</b>	<b>8.25%</b>	<b>7.42%</b>	
Interest Expense (Income), Net	-0.63%	-1.01%	-1.16%	-0.58%	-0.25%	-0.04%	0.00%	0.00%	
Other Income	0.00%	0.00%	0.00%	0.00%	0.00%	2.35%	0.00%	0.00%	
<b>Pretax Income</b>	<b>9.65%</b>	<b>9.97%</b>	<b>5.94%</b>	<b>5.23%</b>	<b>6.22%</b>	<b>9.90%</b>	<b>8.25%</b>	<b>7.43%</b>	
Income Taxes (benefit)	3.62%	3.87%	2.23%	1.87%	2.30%	3.71%	3.01%	2.64%	
<b>Net Income</b>	<b>6.03%</b>	<b>6.10%</b>	<b>3.71%</b>	<b>3.36%</b>	<b>3.92%</b>	<b>6.18%</b>	<b>5.24%</b>	<b>4.78%</b>	
<b>Net Income available to Common</b>	<b>6.03%</b>	<b>6.10%</b>	<b>3.71%</b>	<b>3.36%</b>	<b>3.92%</b>	<b>6.18%</b>	<b>5.24%</b>	<b>4.78%</b>	

Note:

1. Limited data on Peet's because it went public in 2001 and became private in 2012.

**Figure 8-3: Diedrich Common-Size Income Statement (1992 – 2009)**

	1992	1993	1994	1995	1996	1997	1998	1999	2000
Retail sales	100.00%	98.88%	88.63%	87.91%	86.68%	91.45%	90.33%	87.75%	65.62%
Wholesale and other	0.00%	1.12%	11.37%	12.09%	13.32%	8.55%	9.67%	11.43%	25.23%
Franchise	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.83%	9.15%
<b>Net sales</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>
Cost of sales and related occupancy costs	37.07%	38.79%	40.69%	41.68%	43.04%	46.75%	49.86%	45.24%	51.19%
<b>Gross profit</b>	<b>62.93%</b>	<b>61.21%</b>	<b>59.31%</b>	<b>58.32%</b>	<b>56.96%</b>	<b>53.25%</b>	<b>50.14%</b>	<b>54.76%</b>	<b>48.81%</b>
Store operating expenses	32.33%	36.20%	36.11%	34.04%	34.36%	41.79%	45.46%	36.90%	33.18%
Other operating expenses	0.00%	0.20%	3.31%	3.71%	2.70%	1.21%	1.26%	2.62%	2.47%
Depreciation & amortization	2.98%	4.87%	2.31%	3.36%	3.46%	5.32%	7.77%	8.02%	5.82%
Provision for asset impairment and restructuring costs	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	16.98%	0.00%	21.99%
(Gain)/loss on asset disposals	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	-0.03%
General & administrative expenses	26.20%	25.93%	18.33%	11.21%	13.03%	10.11%	17.43%	16.58%	14.02%
<b>Operating income (loss)</b>	<b>1.43%</b>	<b>-5.99%</b>	<b>-0.75%</b>	<b>5.99%</b>	<b>3.41%</b>	<b>-5.19%</b>	<b>-38.76%</b>	<b>-9.35%</b>	<b>-28.63%</b>
Interest expense & other income	3.36%	2.45%	1.25%	1.03%	-0.33%	-0.43%	-0.89%	-1.21%	-1.43%
Pretax income	<b>-1.93%</b>	<b>-8.44%</b>	<b>-1.99%</b>	<b>4.97%</b>	<b>3.07%</b>	<b>-5.62%</b>	<b>-39.65%</b>	<b>-10.56%</b>	<b>-30.09%</b>
Provision (benefit) for income taxes	0.04%	-0.51%	0.02%	0.70%	1.26%	-0.65%	0.00%	0.02%	0.03%
<b>Net income (loss)</b>	<b>-1.97%</b>	<b>-7.93%</b>	<b>-2.02%</b>	<b>4.27%</b>	<b>1.82%</b>	<b>-4.98%</b>	<b>-39.65%</b>	<b>-10.58%</b>	<b>-30.12%</b>
	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
Retail sales	64.96%	62.14%	60.30%	57.88%	60.70%	57.91%	13.52%	9.48%	1.29%
Wholesale and other	25.67%	26.82%	28.00%	28.31%	31.37%	35.74%	76.88%	84.38%	98.58%
Franchise	9.37%	11.04%	11.70%	13.81%	7.93%	6.35%	9.60%	6.14%	0.13%
<b>Net sales</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>
Cost of sales and related occupancy costs	49.43%	48.93%	47.97%	45.97%	50.94%	54.57%	66.23%	77.44%	76.90%
<b>Gross profit</b>	<b>50.57%</b>	<b>51.07%</b>	<b>52.03%</b>	<b>54.03%</b>	<b>49.06%</b>	<b>45.43%</b>	<b>33.77%</b>	<b>22.56%</b>	<b>23.10%</b>
Store operating expenses	28.83%	28.33%	30.81%	30.58%	33.21%	33.55%	26.31%	19.18%	7.00%
Other operating expenses	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Depreciation & amortization	6.15%	3.83%	3.55%	4.19%	4.51%	4.38%	2.89%	2.76%	3.03%
Provision for asset impairment and restructuring costs	3.97%	0.88%	4.07%	0.17%	0.00%	0.00%	2.93%	15.45%	0.00%
(Gain)/loss on asset disposals	-0.24%	-0.68%	-1.58%	0.00%	-0.01%	-0.10%	0.04%	0.16%	-0.02%
General & administrative expenses	15.55%	15.71%	16.85%	17.96%	21.28%	22.79%	18.20%	18.21%	11.55%
<b>Operating income (loss)</b>	<b>-3.69%</b>	<b>2.99%</b>	<b>-1.66%</b>	<b>1.12%</b>	<b>-9.94%</b>	<b>-15.19%</b>	<b>-16.60%</b>	<b>-33.21%</b>	<b>1.54%</b>
Interest expense & other income	-1.78%	-0.86%	-0.47%	-0.58%	0.11%	0.73%	0.56%	0.66%	-1.98%
Pretax income	<b>-5.47%</b>	<b>2.13%</b>	<b>-2.13%</b>	<b>0.54%</b>	<b>-9.83%</b>	<b>-14.46%</b>	<b>-16.03%</b>	<b>-32.55%</b>	<b>-0.44%</b>
Provision (benefit) for income taxes	0.05%	0.09%	0.10%	0.05%	-3.52%	-1.35%	5.79%	1.16%	-0.15%
<b>Net income (loss)</b>	<b>-5.52%</b>	<b>2.04%</b>	<b>-2.23%</b>	<b>0.49%</b>	<b>27.83%</b>	<b>-13.11%</b>	<b>-4.82%</b>	<b>-29.73%</b>	<b>2.55%</b>

Note:

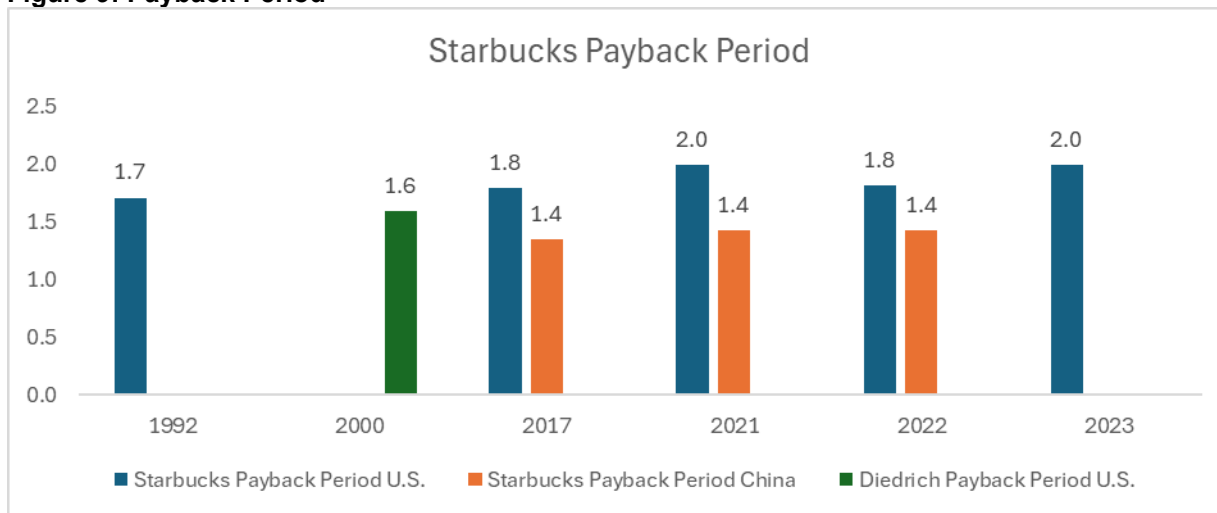
1. Limited data on Diedrich because it went public in 1996 and acquired by Green Mountain Coffee Roasters in 2009.

## B. Store Operations

Store location is a crucial factor for Starbucks, contributing to both operational and marketing efficiency. **The company strategically places its stores in high-traffic, high-visibility locations in both established and emerging markets to maximize efficiency and brand exposure. These locations include office buildings, downtown and suburban retail centers, as well as kiosks in building lobbies, airport terminals, and supermarket foyers.**<sup>76</sup> For example, when Starbucks opened its first international store in 1987, it chose a spot in Vancouver, Canada, near the SeaBus terminal, office buildings, and downtown hotels. The first store outside North America, opened in 1996, was in Ginza, Japan, a bustling shopping district.

By choosing high-traffic locations, Starbucks maintains steady inventory turnover and achieves a short payback period for new store openings. **The average payback period for a new store in the U.S. was 1.7 years,<sup>77</sup> consistently under 2 years for decades.** Diedrich Coffee, a competitor, had a similar payback period, as indicated in Figure 9. Although Peet's never publicly disclosed its store payback period, Jerry Baldwin mentioned that it cost approximately \$250,000 to open a store, with a short payback period.<sup>78</sup>

**Figure 9: Payback Period<sup>79</sup>**



**Note:**

1. The payback period is derived from the company's disclosure of single-store economics such as ROI or cash margin.
2. Peet's did not disclose enough information to derive its store economics.
3. Based on Diedrich's 2000 annual report, its estimated that its store payback period in Orange County is 1.6 years, taking the middle point of pre-opening expenses between \$300,000 and \$375,000, and average cashflow of \$211,000 per store in Orange County locations.<sup>80</sup>

<sup>76</sup> Starbucks Prospectus and Annual Reports.

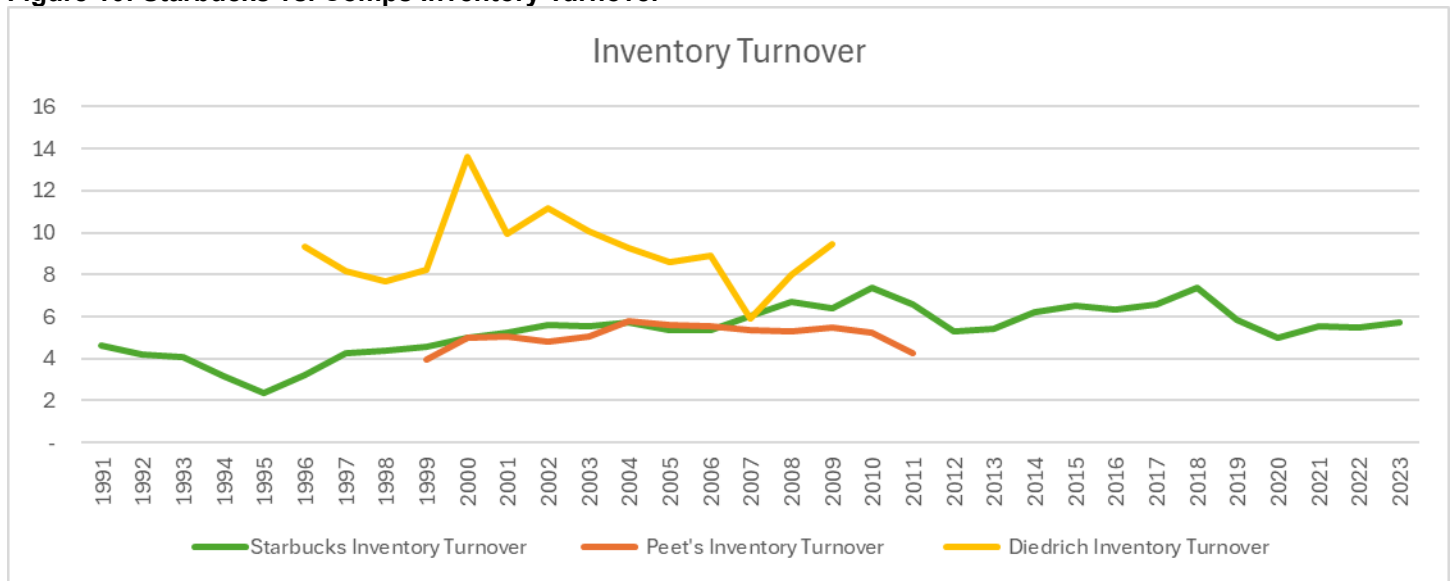
<sup>77</sup> Pg. 20, Starbucks Prospectus and Annual Reports.

<sup>78</sup> Discussion with Jerry Baldwin.

<sup>79</sup> Company disclosures.

<sup>80</sup> Diedrich Annual Report 2000.

Figure 10: Starbucks vs. Comps Inventory Turnover



Notes:

1. Limited data on Peet's because it went public in 2001 and became private in 2012.
2. Limited data on Diedrich because it went public in 1996 and acquired by Green Mountain Coffee Roasters in 2009.
3. Inventory turnover ratio is calculated as COGS divided by the average of current Inventory and previous Inventory.

Starbucks stores consist of two types, 1) company-operated stores and 2) licensed stores, which are common among the industry. **As of 2003, all company-operated stores are on leased premises. In 2023, almost all stores are on leased premises.** This approach is similar to that of Diedrich and Peet's, where all company-operated stores were leased.<sup>81</sup> Starting in 1991, the company started licensing Starbucks store operations in different markets such as airports and new markets to receive a license fee and royalty from sales, and to sell coffees and related products for resale in the licensed locations. The company considers licensing its operations to licensee partners when they can provide improved and, at times, the only access to desirable retail space,<sup>82</sup> such as entering a new market, especially in the international market. For example, in 1996, when the company first entered Japan, it created a joint-venture with a local company to develop retail stores in Japan.<sup>83</sup> In 1998, it signed licensing agreements with a local company to expand the China market.<sup>84</sup> Licensing Starbucks meant that it did not have to bear the expenses running in a new market and it could sell products to the licensees for resale and collect royalty payments. The royalty payments with different partners or food categories could vary. For example, Host International (airport restaurant operator), paid Starbucks a royalty of 5% on gross revenue excluding the sale of pastries and 2.5% from the Specialty Sandwich Program.<sup>85</sup>

As Figure 11-1 shows, licensed stores increased from 2% of the company's total stores since its first launch in 1991 to 50% in 2014 and remain below 50% most of the time. However, sales from company-operated stores have contributed between 80% and 90% to the company's overall sales since 1987.

<sup>81</sup> Diedrich Annual Reports 1997 – 2008; Discussion with Jerry Baldwin.

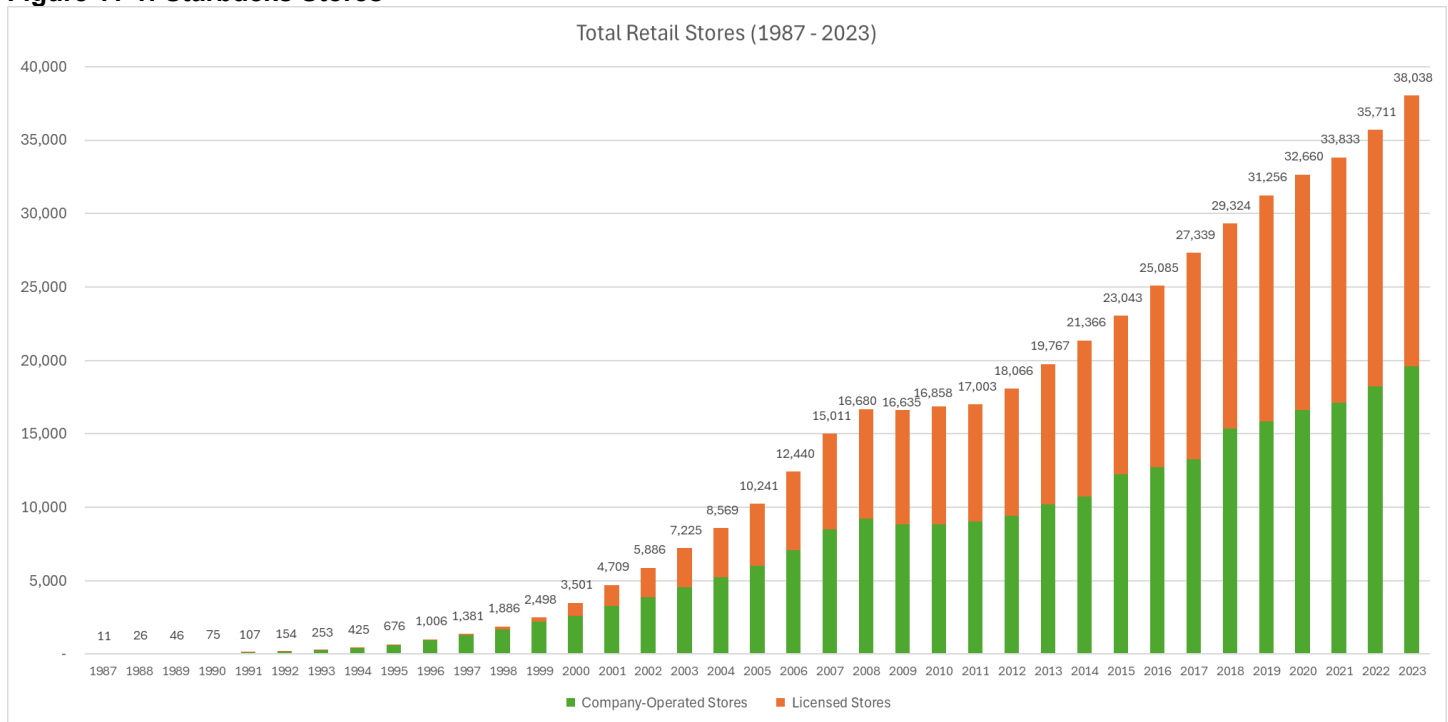
<sup>82</sup> Starbucks Annual Report 2007.

<sup>83</sup> Starbucks Annual Report 1996.

<sup>84</sup> Starbucks Annual Report 1998.

<sup>85</sup> Starbucks Annual Report 2000.

**Figure 11-1: Starbucks Stores**



**Notes:**

1. The numbers of stores each year are provided in the company's annual reports and prospectus.
2. The company claims in its prospectus that it had 11 stores at the end of fiscal 1987. It claims that it had 17 stores at the end of fiscal 1987 in its 1994 annual report.

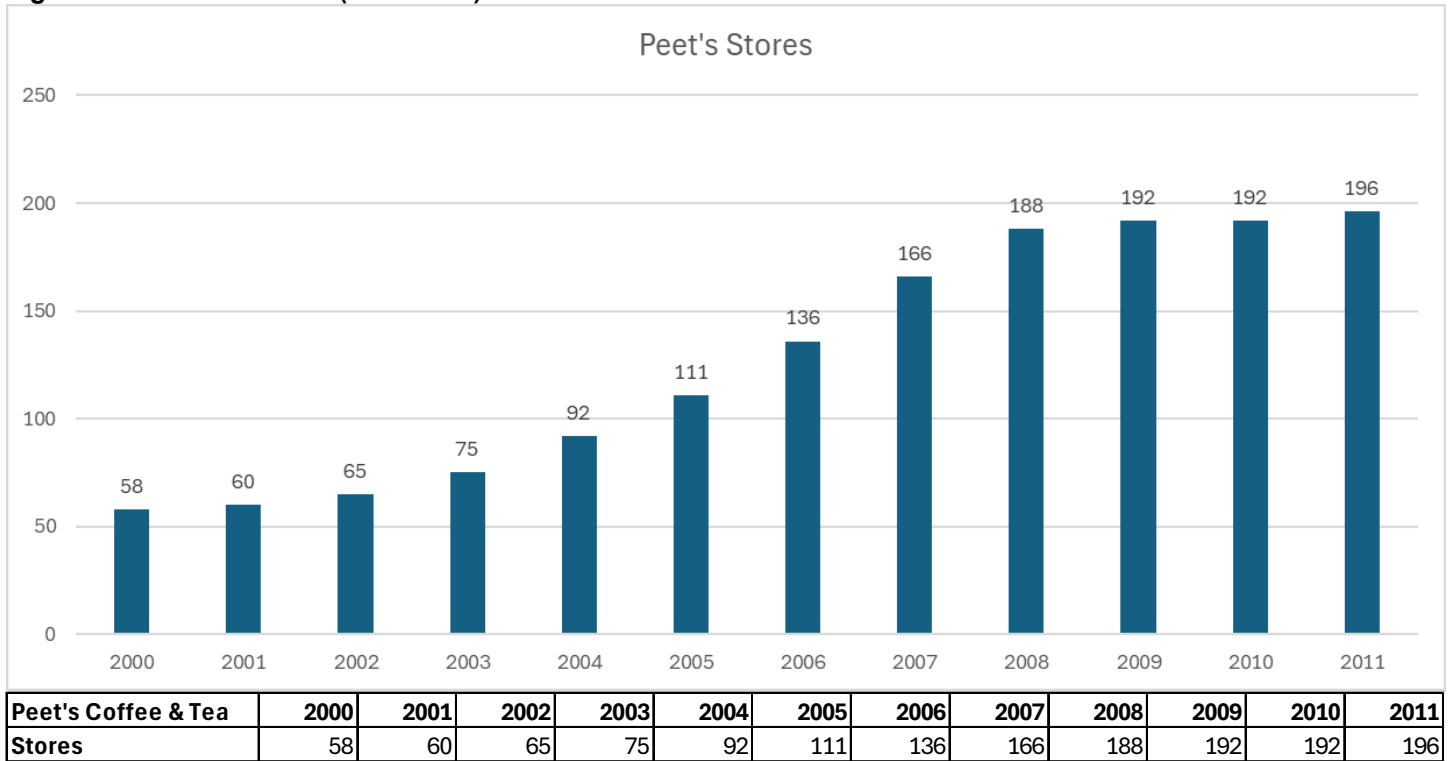
	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<b>Company-Operated Stores</b>	11	26	46	75	105	151	243	399	627	929	1,270	1,688	2,217	2,619	3,266	3,880	4,546	5,215	6,000
Company-Operated Stores - North America	11	26	46	75	105	151	243	399	627	929	1,270	1,622	2,038	2,446	2,971	3,496	4,095	4,665	5,301
Company-Operated Stores - International	-	-	-	-	-	-	-	-	-	-	-	66	179	173	295	384	451	550	699
<b>Licensed Stores</b>	-	-	-	-	2	3	10	26	49	77	111	198	281	882	1,443	2,006	2,679	3,354	4,241
Licensed Stores - North America	-	-	-	-	2	3	10	26	49	75	94	133	97	530	809	1,078	1,475	1,905	2,553
Licensed Stores - International	-	-	-	-	-	-	-	-	-	2	17	65	184	352	634	928	1,204	1,449	1,688
<b>Total</b>	<b>11</b>	<b>26</b>	<b>46</b>	<b>75</b>	<b>107</b>	<b>154</b>	<b>253</b>	<b>425</b>	<b>676</b>	<b>1,006</b>	<b>1,381</b>	<b>1,886</b>	<b>2,498</b>	<b>3,501</b>	<b>4,709</b>	<b>5,886</b>	<b>7,225</b>	<b>8,569</b>	<b>10,241</b>
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
<b>Company-Operated Stores</b>	7,102	8,505	9,217	8,832	8,833	9,031	9,405	10,194	10,713	12,235	12,711	13,275	15,341	15,834	16,637	17,133	18,253	19,592	
Company-Operated Stores - North America	6,236	7,389	7,969	7,539	7,506	7,541	7,744	7,989	8,286	8,568	8,915	9,305	9,684	9,974	10,109	9,861	10,216	10,628	
Company-Operated Stores - International	866	1,116	1,248	1,293	1,327	1,490	1,661	2,205	2,427	3,667	3,796	3,970	5,657	5,860	6,528	7,272	8,037	8,964	
<b>Licensed Stores</b>	5,338	6,506	7,463	7,803	8,025	7,972	8,661	9,573	10,653	10,808	12,374	14,064	13,983	15,422	16,023	16,700	17,458	18,446	
Licensed Stores - North America	3,346	4,125	4,560	4,626	4,698	4,366	4,565	4,805	5,121	5,311	5,661	6,085	6,440	6,682	6,831	6,965	7,079	7,182	
Licensed Stores - International	1,992	2,381	2,903	3,177	3,327	3,606	4,096	4,768	5,532	5,497	6,713	7,979	7,543	8,740	9,192	9,735	10,379	11,264	
<b>Total</b>	<b>12,440</b>	<b>15,011</b>	<b>16,680</b>	<b>16,635</b>	<b>16,858</b>	<b>17,003</b>	<b>18,066</b>	<b>19,767</b>	<b>21,366</b>	<b>23,043</b>	<b>25,085</b>	<b>27,339</b>	<b>29,324</b>	<b>31,256</b>	<b>32,660</b>	<b>33,833</b>	<b>35,711</b>	<b>38,038</b>	

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Company-Operated Stores - North America as a % of Total North America Stores	100%	100%	100%	100%	98%	98%	96%	94%	93%	93%	93%	92%	95%	82%	79%	76%	74%	71%	67%
Licensed Stores - North America as a % of Total North America Stores	0%	0%	0%	0%	2%	2%	4%	6%	7%	7%	7%	8%	5%	18%	21%	24%	26%	29%	33%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
Company-Operated Stores - International as a % of Total International Stores	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	50%	49%	33%	32%	29%	27%	28%	29%
Licensed Stores - International as a % of Total International Stores	0%	0%	0%	0%	0%	0%	0%	0%	0%	100%	100%	50%	51%	67%	68%	71%	73%	72%	71%
<b>Total</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
Company-Operated Stores As a % of Total Stores	100%	100%	100%	100%	98%	98%	96%	94%	93%	92%	92%	90%	89%	75%	69%	66%	63%	61%	59%
Licensed Stores As a % of Total Stores	0%	0%	0%	0%	2%	2%	4%	6%	7%	8%	8%	10%	11%	25%	31%	34%	37%	39%	41%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
Company-Operated Stores - North America as a % of Total North America Stores	65%	64%	64%	62%	62%	63%	63%	62%	62%	62%	61%	60%	60%	60%	60%	59%	59%	60%	
Licensed Stores - North America as a % of Total North America Stores	35%	36%	36%	38%	38%	37%	37%	38%	38%	38%	39%	40%	40%	40%	40%	41%	41%	40%	
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	
Company-Operated Stores - International as a % of Total International Stores	30%	32%	30%	29%	29%	29%	29%	32%	30%	40%	36%	33%	43%	40%	42%	43%	44%	44%	
Licensed Stores - International as a % of Total International Stores	70%	68%	70%	71%	71%	71%	71%	68%	70%	60%	64%	67%	57%	60%	58%	57%	56%	56%	
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	
Company-Operated Stores As a % of Total Stores	57%	57%	55%	53%	52%	53%	52%	52%	50%	53%	51%	49%	52%	51%	51%	51%	51%	52%	
Licensed Stores As a % of Total Stores	43%	43%	45%	47%	48%	47%	48%	48%	50%	47%	49%	51%	48%	49%	49%	49%	49%	48%	
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Company-Operated Stores Revenue as a % of Total Net Revenue	81%	79%	81%	85%	87%	87%	87%	87%	#N/A	86%	86%	84%	85%	84%	84%	85%	85%	84%	85%
Licensed Stores Revenue as a % of Total Net Revenue	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	4%	5%	6%	6%	6%
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
Company-Operated Stores Revenue as a % of Total Net Revenue	85%	85%	84%	84%	84%	82%	79%	79%	79%	79%	79%	79%	80%	81%	81%	85%	82%	82%	
Licensed Stores Revenue as a % of Total Net Revenue	7%	7%	7%	8%	8%	9%	9%	9%	10%	10%	10%	11%	11%	11%	10%	9%	11%	13%	

Figure 11-2: Peet's Stores (2000-2011)<sup>86</sup>

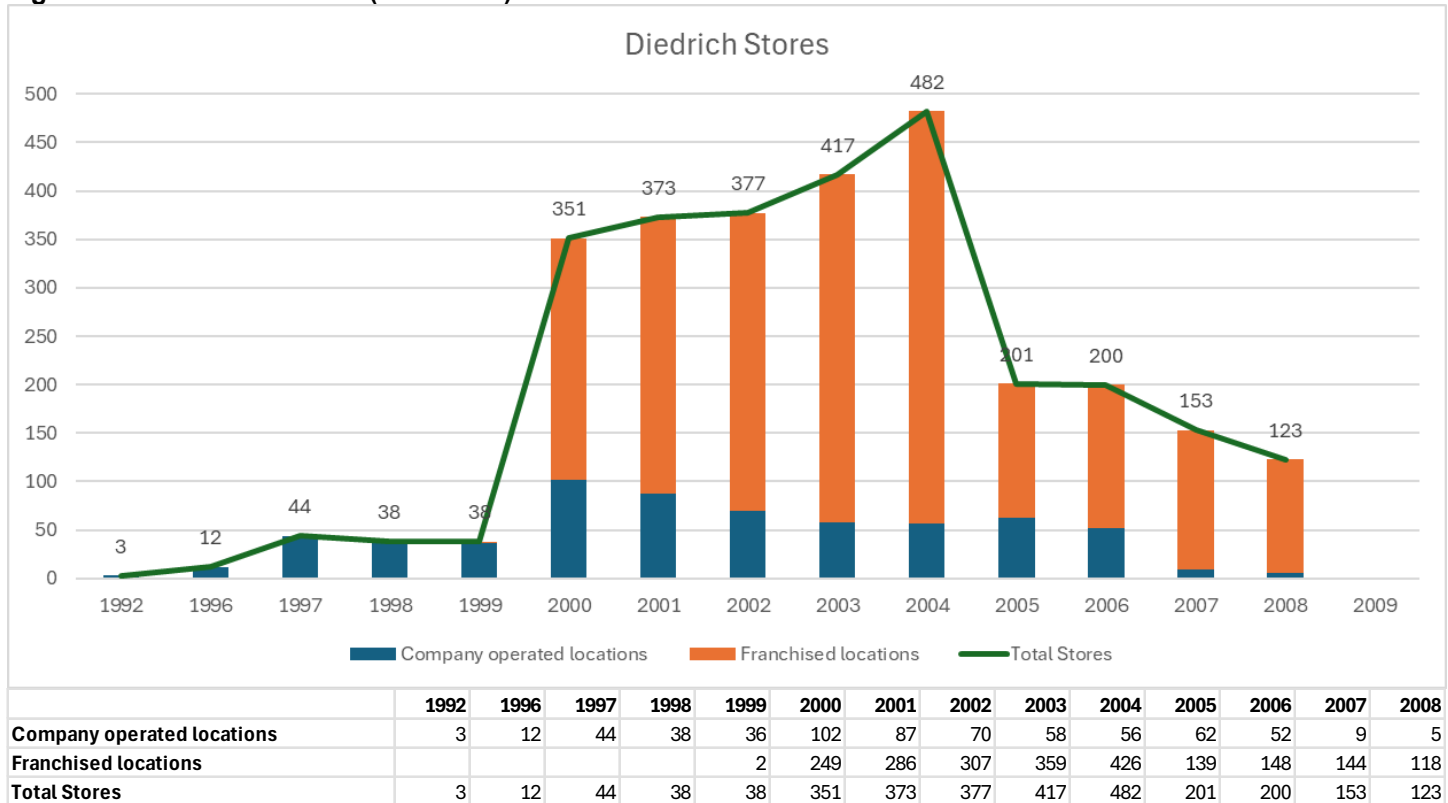


Notes:

<sup>86</sup> Peet's Annual Reports 2001-2011.

1. Peet's went public in 2001 and was taken private in 2012.
2. Peet's operated only in the U.S. across 6 states as of FY2011 with over 170 in California.<sup>87</sup>

**Figure 11-3: Diedrich Stores (2000-2011)**



**Notes:**

1. In 2000, Diedrich acquired Coffee People and its 278 Gloria Jean's mall coffee shops.
2. In 2005, Diedrich sold Gloria Jean's international franchise operations.
3. Starting in 2006, the company started to sell its retail business to other companies, including Starbucks, to focus on wholesale of coffee, and eventually was acquired by Green Mountain Coffee.

**Figure 12: Starbucks Pre-IPO Period**

Pre-Initial Public Offering Period	1987	1988	1989	1990	1991
<b>Net Sales (Thousands)</b>	1,269	10,213	19,219	35,392	57,650
<b>Year-Over-Year Growth</b>		705%	88%	84%	63%
<b>Comparable Store Sales</b>				23%	15%
<b>Stores in Operation, end of year</b>	11	26	46	75	107
<b>Year-Over-Year Growth</b>		136%	77%	63%	43%

**Note:**

1. Starbucks disclosed in its prospectus that it ran 126 stores as of March 1992, before the IPO.

Since its IPO, Starbucks has observed a decrease in its accounts receivable turnover, hovering around 30, as depicted in Figure 13-1. While the company has not provided detailed explanations for the increase in accounts receivable during the initial years, it did mention that licensees' receivables, including the international market, typically take longer to be settled.<sup>88</sup> From 1991 to 2023, the proportion of licensed stores surged from 2% to 48%, as Figure 13-2 shows. This coincides with Diedrich when it acquired Gloria's Jean in 2000, which franchised most of its stores.

When it comes to owned stores, accounts receivable stem from customers who pay instantly with cash or within a few days using credit cards. Conversely, in licensed stores, accounts receivable originates from licensees who remit a percentage of revenue over an agreed-upon timeframe. Although the specifics of the licensing agreements regarding payment duration to Starbucks remain undisclosed, it is apparent that accounts receivable terms for licensed stores

<sup>87</sup> Peet's Annual Report 2011.

<sup>88</sup> Starbucks 2000.

extend over a longer period compared to those for customers at owned stores, where payments are settled at the point of purchase with cash or within a short timeframe with credit cards.

**Figure 13-1: Starbucks Turnover Ratios (1991-2023)**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Accounts Receivable Turnover	83.4	76.8	73.8	69.0	61.0	50.7	40.2	32.1	34.1	35.1	31.8	35.0	38.4	41.6	38.5	37.5	36.7
Inventory Turnover	4.6	4.2	4.1	3.2	2.4	3.2	4.3	4.4	4.6	5.0	5.3	5.6	5.6	5.7	5.4	5.4	6.0
Accounts Payable Turnover	11.9	12.1	17.8	21.5	14.8	8.9	11.1	11.9	14.1	15.0	11.2	10.5	11.6	12.4	13.0	11.6	11.1
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
Accounts Receivable Turnover	33.6	32.6	37.3	34.0	30.5	28.4	27.6	28.4	28.7	27.3	31.6	33.7	26.7	31.9	30.5	30.5	
Inventory Turnover	6.7	6.4	7.4	6.6	5.3	5.4	6.2	6.5	6.3	6.6	7.4	5.8	5.0	5.5	5.5	5.7	
Accounts Payable Turnover	13.0	14.5	15.8	13.1	13.0	14.1	13.3	13.1	12.1	11.9	10.4	7.3	7.1	8.0	8.2	7.4	

**Figure 13-2: Starbucks Company-Owned vs. Licensed-Stores as Percentage of Total Stores**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Company-Operated Stores As a % of Total Stores	98%	98%	96%	94%	93%	92%	92%	90%	89%	75%	69%	66%	63%	61%	59%	57%	57%
Licensed Stores As a % of Total Stores	2%	2%	4%	6%	7%	8%	8%	10%	11%	25%	31%	34%	37%	39%	41%	43%	43%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
Company-Operated Stores As a % of Total Stores	55%	53%	52%	53%	52%	52%	50%	53%	51%	49%	52%	51%	51%	51%	51%	52%	
Licensed Stores As a % of Total Stores	45%	47%	48%	47%	48%	48%	50%	47%	49%	51%	48%	49%	49%	49%	49%	48%	
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	

**Figure 14: Peet's Turnover Ratios (1999-2011)**

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Accounts Receivable Turnover	115.9	99.5	81.2	58.1	45.0	40.2	37.7	35.1	33.0	28.2	22.9	22.2	21.0
Inventory Turnover	3.9	5.0	5.0	4.8	5.1	5.8	5.6	5.5	5.4	5.3	5.5	5.2	4.2
Accounts Payable Turnover	6.8	8.8	9.6	9.4	9.7	13.2	14.9	9.3	11.7	13.5	12.1	14.2	20.0
Cash Conversion Cycle	41.8	35.6	39.3	43.3	42.8	44.8	50.6	36.8	47.6	55.2	52.3	60.9	85.1

Note:

- Limited data on Peet's because it went public in 2001 and became private in 2012.

**Figure 15: Diedrich Turnover Ratios (1995-2009)**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Accounts Receivable Turnover	228.2	101.9	114.9	117.3	108.8	56.8	35.4	31.6	23.5	22.8	23.1	23.6	10.6	10.2	11.0
Inventory Turnover	21.1	9.3	8.2	7.7	8.3	13.6	10.0	11.2	10.1	9.3	8.6	8.9	5.9	8.0	9.4
Accounts Payable Turnover	16.6	9.6	8.9	8.5	9.3	10.9	8.9	15.2	13.7	13.1	12.1	12.0	8.2	8.8	9.6
Cash Conversion Cycle	(3.1)	4.7	6.9	8.0	8.2	(0.3)	6.1	20.2	25.2	27.6	28.2	25.9	51.2	39.9	33.9

Note:

- Diedrich acquired Gloria's Jean in 2000, which franchised most of its stores.
- Limited data on Diedrich because it went public in 1996 and acquired by Green Mountain Coffee Roasters in 2009.

**Figure 16: Ratio Comparison (1999-2009)**

Average	Starbucks	Peet's	Diedrich
AR Turnover	35.9	54.3	32.5
Inventory Turnover	5.6	5.2	9.4
AP Turnover	12.5	10.8	11.1
Cash Conversion	46.7	44.5	25.8

Note:

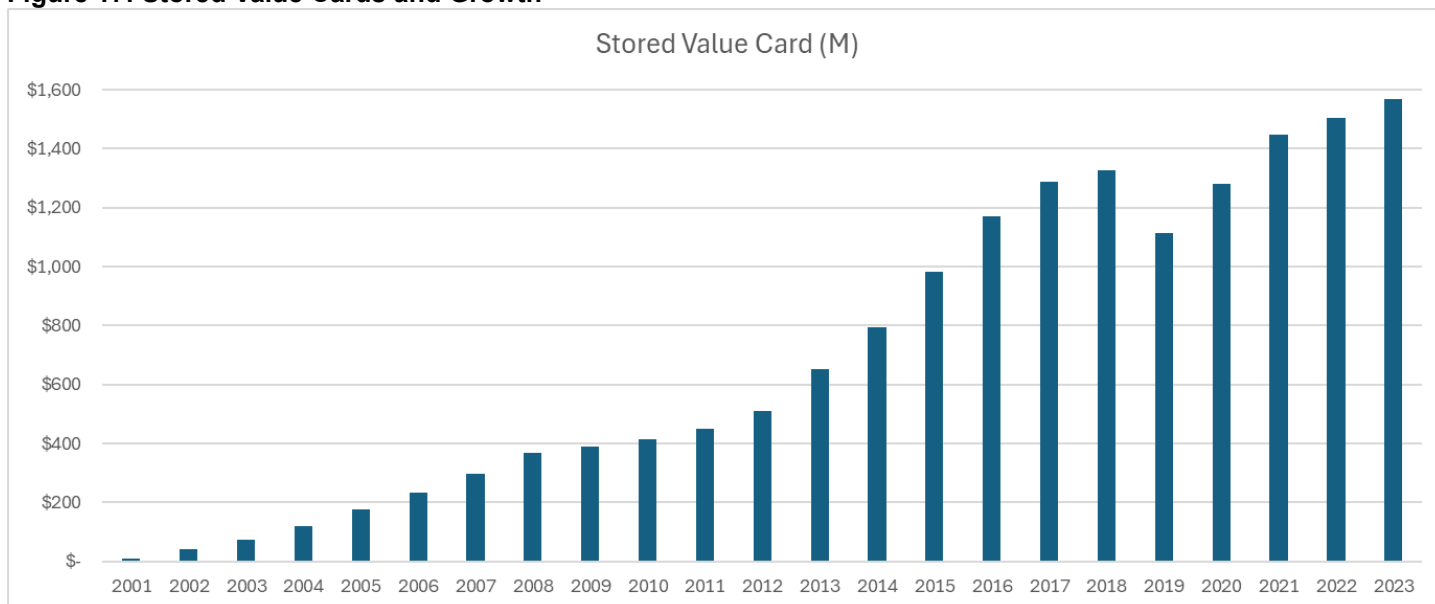
1. 1999 to 2009 is the common period with comparable data for the three companies.

### C. Loyalty Program Format

Starbucks launched its first Starbucks Gift Card in November 2001, and later Starbucks Reward, also offering a digital version as well. The company has an in-house creative team dedicated to designing reloadable gift cards in various styles, materials, and shapes. They produce different graphics for holidays, keychain designs, and other unique themes. Since its debut in 2001, the value stored by customers on these accounts has grown from \$10 million to over \$1.7 billion by the end of 2023, representing a compound annual growth rate (CAGR) of 25%, as Figure 17 shows.

The stored value on these accounts is recognized as deferred revenue, which can be realized as revenue when customers redeem their gift cards. This not only contributes to future revenue streams but also promotes customer loyalty, as customers with loaded gift cards are more likely to shop at Starbucks again. Moreover, when someone receives a Starbucks Gift Card as a gift, it can lead to new customers discovering and becoming regular patrons of the brand.

**Figure 17: Stored Value Cards and Growth**



Note:

1. Decline in 2019 is because of change in FASB guidance, and some of the stored values are classified into deferred revenue under long-term assets, of which details are not disclosed.

Since Starbucks stored value does not have an expiration date and does not incur any fees or interest on the stored value, the company could effectively use these funds like interest-free debt for its operations. Stored value card liabilities are projected to increase significantly, from under \$10 million in FY2001 to \$1.6 billion in FY2023. This represents a growth from 0.5% to over 5% of the company's total assets, with a CAGR of 25%. This structure benefits Starbucks by providing a source of capital without the usual costs associated with borrowing. The stored value can be used at any time, giving customers flexibility while offering the company a financial buffer that can support ongoing business needs.

As of Q1 FY2024 in the U.S., the number of 90-day active Starbucks Reward members reached 34.3 million.<sup>89</sup> A key advantage of the reward program is the data it provides, enabling Starbucks to make informed decisions. **Former CTO Gerri Martin-Flickinger explained in 2016 that “with our 90 million transactions a week we know a lot about what people are buying, where they’re buying, how they’re buying, and if we combine this information with other data, like weather, promotions, inventory, insights into local events, we can actually deliver better-personalized service to other customers.”**<sup>90</sup>

This data-driven strategy allows Starbucks to test new ideas, implement targeted promotions, launch new products, reduce menu items, or adjust flavors to suit specific regions and customer segments. By leveraging such detailed information, Starbucks enhances customer experiences and stays competitive in a dynamic market.

#### **D. Expansion Strategy**

As discussed earlier, store location is crucial for Starbucks in terms of both operational efficiency and marketing effectiveness. The company strategically chooses high-traffic, high-visibility locations in both existing and new markets to optimize operations, boost marketing efficiency, and increase brand visibility. These locations include office buildings, downtown and suburban retail centers, and kiosks in places like building lobbies, airport terminals, and supermarket foyers.<sup>91</sup> By selecting such prime locations, Starbucks aims to attract a steady flow of customers while reinforcing its brand presence.

In the early days, specifically in the 1990s, when social media and big data were non-existent, Starbucks employed direct mail orders as a significant strategy for entering new markets in the U.S. This approach later expanded to include online orders. Long before Starbucks became the coffeehouse giant it is today, the company established a mail-order business,<sup>92</sup> beginning in 1988. They issued a quarterly direct mail catalog that offered whole-bean coffees, select food items, and a range of coffee-making accessories and equipment.

By March 1992, just before the company went public, Starbucks was shipping products to over 25,000 direct mail customers across all 50 states and even to some foreign countries.<sup>93</sup> At the time, direct mail accounted for 2.7% of the company's total sales. Starbucks believed that this direct mail business supported its retail expansion into new markets and helped reinforce brand recognition. While direct mail sales contributed a relatively small portion to overall revenue, this business provided valuable insights into new markets and served as a useful marketing tool.

However, the proportion of sales from mail orders as a percentage of total revenue declined over the years, dropping from nearly 3% in 1992 to about 1% in 2002, as Figure 18 shows. Although direct mail never became a major revenue source for Starbucks, it played a critical role in increasing brand awareness in both existing and new markets, laying the groundwork for the company's future expansion. This strategy helped Starbucks gain a foothold in new locations and facilitated its growth into the coffeehouse giant it is today.

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<sup>89</sup> Bank of America and Starbucks Launch Loyalty Partnership. <https://stories.starbucks.com/press/2024/bank-of-america-and-starbucks-launch-loyalty-partnership/>

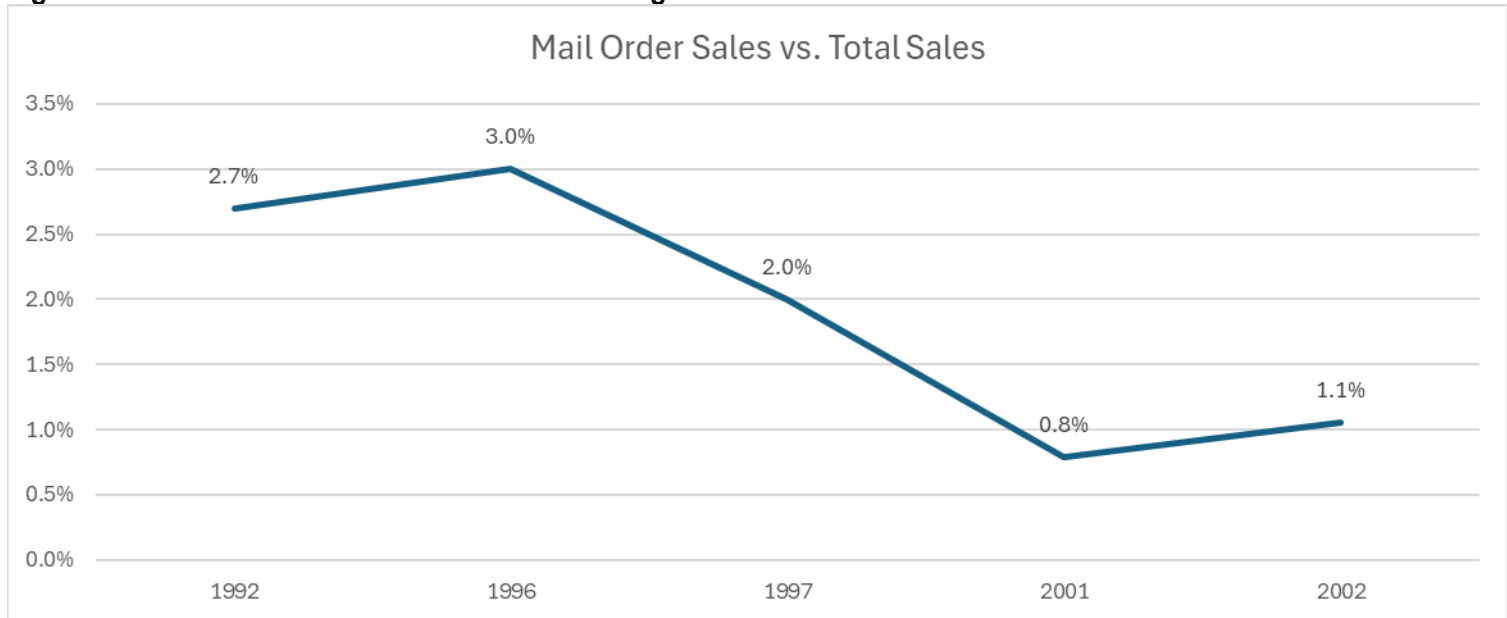
<sup>90</sup> How Starbucks Uses Data and Insights to Win Big. <https://techhq.com/2018/09/how-starbucks-uses-data-and-insights-to-win-big/#:~:text=%E2%80%9CWith%20our%2090%20million%20transactions,personalized%20service%20to%20other%20customers%20%E2%80%9D>

<sup>91</sup> Starbucks Prospectus and Annual Reports.

<sup>92</sup> Chapter 8, Pour Your Heart Into It.

<sup>93</sup> Starbucks Prospectus.

**Figure 18: Starbucks' Mail Order Sales as Percentage of Overall Sales<sup>94</sup>**



**Notes:**

1. The company stopped disclosing its mail order sales post-2002.
2. 2001 and 2002 percentages are derived from the Starbucks disclosure that its direct-to-consumer business accounted for 5% and 7% of specialty revenues, respectively.

In 1993, Starbucks took its first step into the East Coast, choosing Washington, D.C., as the location for its first store. The decision was largely driven by the fact that Washington, D.C., had the highest concentration of Starbucks mail-order customers on the East Coast. These mail-order customers were a key indicator of potential market success, as they demonstrated a consistent demand for Starbucks coffee, even in areas without physical stores. Starbucks also recognized that mail-order customers tend to be among the most loyal, requiring a steady supply of Starbucks coffee regardless of their geographical location. The company's research indicated that these customers generally shared a specific demographic profile: they were sophisticated coffee consumers, well-educated, relatively affluent, well-traveled, and technologically savvy. Moreover, they showed a significant interest in the arts and other cultural events, aligning with the lifestyle and values Starbucks aimed to promote.<sup>95</sup>

By focusing on these customers, Starbucks not only gained insights into new markets but also ensured a strong foundation for its East Coast expansion. The characteristics of this customer base helped Starbucks tailor its approach to the unique demands and preferences of a new region, supporting its broader strategy of entering untapped markets with a loyal following.

Starbucks tailors its expansion strategy based on the specific location and the competitive landscape of the target market. For instance, before officially entering New York City, Starbucks strategically opened stores in the surrounding Fairfield and Westchester counties, where many influential professionals working in Manhattan resided. By the time Starbucks opened its first store in New York in 1994, it had already garnered a reputation as the best coffee in the city.<sup>96</sup>

In the same year, when Starbucks entered the Boston market, it faced a different competitive scenario. A local competitor, The Coffee Connection, which operated 10 stores, took notice of Starbucks' arrival, and quickly reacted by hiring a former hotel executive to help the company secure venture capital funding, with plans to expand to over 60 stores by 1997. Instead of engaging in a direct competition, Starbucks opted for a different approach: it acquired The Coffee Connection through a stock swap valued at \$23 million, instantly becoming a leading coffee shop in Boston. This acquisition strategy provided Starbucks with a rapid boost in brand recognition and immediate access to the existing customer base and locations of the competitive company. It allowed Starbucks to quickly establish a strong presence in a new market without

<sup>94</sup> Starbucks Annual Reports, 1992, 1996, 1997, 2001, and 2002.

<sup>95</sup> Chapter 14, Pour Your Heart Into it.

<sup>96</sup> Chapter 14, Pour Your Heart Into It.

the typical hurdles of building a new network from scratch. Buying out local competitors proved to be an effective way to accelerate growth and gain a foothold in competitive environments.<sup>97</sup>

**Each time Starbucks open a new store, it will send a team of experienced managers and baristas from existing stores and use a buddy system to provide new employees with one-on-one training.<sup>98</sup>**

As Starbucks built its brand over the early years, it gradually started licensing some of its stores. Between 1991 and 2023, the percentage of licensed stores in the company's total number of stores rose from 2% to 48%, stabilizing around 50% after 2010. If implemented correctly, licensing can be a fast way to raise capital, allowing the licensor to quickly expand into new markets and preempt the competition. **However, unlike some of its competitors, Starbucks maintained strict control over its stores, ensuring a strong brand identity and consistent quality.**

Starbucks initially operated all its stores directly. In 1991, with nearly 100 company-operated stores, it began to experiment with licensing by partnering with Host Marriott for airport locations. The goal was to expose travelers to Starbucks coffee and increase brand awareness globally.<sup>99</sup> Despite the licensing, Starbucks ensured that these licensed-operated stores maintained the same high standards as its company-operated locations, with rigorous employee training, consistent product quality, and excellent customer service. This approach allowed Starbucks to gradually expand its licensing business to other markets and partners as it gained more experience with this business model.

Gloria Jean's Coffee, a chain founded in Chicago, took a different approach, starting to franchise nationwide in 1986.<sup>100</sup> By late 1991, Gloria Jean's had over 120 stores, while Starbucks had 110, nearly all of which were company-operated. However, Gloria Jean's never developed the strong brand recognition that Starbucks achieved, and the chain changed ownership several times. In 1999, Gloria Jean's was acquired by Diedrich Coffee, a California-based competitor of Starbucks, and was later sold to other companies.

Starbucks' success in maintaining a strong brand identity through tight control over its licensed stores demonstrates the importance of consistency in quality and customer experience, especially when expanding into new markets. This approach contrasts with other licensees, which, without a solid brand foundation, often struggle to maintain relevance and stability. **To ensure a consistent quality of the food and drinks that Starbucks offers in both company-operated and licensed stores, the company hired former executives of McDonald's, which is renowned for maintaining consistent product quality across their chain.<sup>101</sup>**

As Figures 19 and 20 show, in 1993, the United States boasted 2,850 specialty coffee shops, with Starbucks holding 253 stores, including a few in Canada, which the number was not disclosed. By 2003, industry expanded significantly, with the U.S. hosting 17,400 specialty coffee shops, while Starbucks alone had 5,201 stores nationwide, comprising 3,779 company-operated stores and 1,422 licensed locations. In 2013, the specialty coffee scene in the U.S. had expanded even further, reaching 29,300 stores, while Starbucks had grown to 11,045 stores within the country, of which 6,856 were company-operated and 4,189 were licensed, solidifying Starbucks' prominent position within the market. **Despite being part of a fragmented and highly competitive market, these figures of Starbucks represent approximately 8% of all specialty coffee shops in the U.S. in 2008, 30% in 2003 and about 38% in 2013.** The number of specialty coffee shops in the U.S., as estimated by the Specialty Coffee Association, surged from 2,850 to 29,300 during this period.<sup>102</sup>

One of Starbucks' closest competitors, Peet's Coffee, had a much smaller presence. In 2003, Peet's accounted for only about 0.43% of all specialty coffee shops in the U.S., and by 2013, its market share had increased only slightly to nearly 0.6%, based on its 196 shops in 2011 (due to limited data). This significant difference in market share demonstrates Starbucks' dominance and growth over the decade, even in a competitive industry with numerous smaller players.

According to Jerry Baldwin, a key reason for Starbucks' rapid expansion was Howard Schultz's innate desire to build something big, supported by experienced investors.<sup>103</sup> This aligns with Schultz's recounting of his early experiences

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<sup>97</sup> Chapter 14, Pour Your Heart Into It.

<sup>98</sup> Chapter 18, Pour Your Heart Into It.

<sup>99</sup> Chapter 12, Pour Your Heart Into It.

<sup>100</sup> Chapter 18, Pour Your Heart Into It.

<sup>101</sup> Discussion with Martin Diedrich.

Career Insights from A Starbucks Supply Chain Executive. <https://mitsloan.mit.edu/ideas-made-to-matter/career-insights-a-starbucks-supply-chain-executive>

<sup>102</sup> Specialty Coffee Association

<sup>103</sup> Discussion with Jerry Baldwin.

building Starbucks in his book, *Pour Your Heart into It*. In contrast, when Baldwin and his partners took over Peet's, their goal was simply to run coffee shops, not to build a large business. They were content with opening just one store per year and never aimed to be the biggest or fastest-growing company.<sup>104</sup>

Additionally, similar to his early days at Starbucks, Jerry Baldwin's initial focus was on selling Peet's beans in-store. Therefore, many Peet's stores were designed with the beans placed at the end of the counter, creating the illusion that this area was the "altar" of the store.<sup>105</sup> In contrast, Howard Schultz focused on making the espresso machine the centerpiece, emphasizing the interaction between the barista and the customer every time a drink was made. Baldwin, like Schultz, also stressed the importance of the social aspect of coffee shops, as well as quality, brand, and atmosphere.

Baldwin recalled that in the late 1980s, Peet's had only 10 shareholders, with a total investment of around \$30,000, while the company was already generating millions in sales with forthcoming dividends.<sup>106</sup> However, after Starbucks went public in 1992, Peet's began to feel pressure from professional investors. At that time, Peet's had around 10 stores. To respond to this new pressure, the company eventually brought in professional managers and shifted its focus towards increasing its valuation, with an eye to pursuing an IPO.

In 1995, Peet's hired a new CEO as part of this shift. From 1997 to 2002, under the leadership of another CEO, Christopher Mottern, Peet's re-entered the supermarket business, a change from Baldwin's earlier strategy when he had eliminated 9 out of 10 wholesale accounts after acquiring Peet's.<sup>107</sup> **Although Baldwin did not believe that going public in 2001 significantly changed the company's culture, he did observe a growing focus on short-term quarterly results, which had not been the case previously.**<sup>108</sup>

In 2002, Peet's hired Patrick O'Dea, the former CEO of Archway/Mother's Cookies and a former marketer of snack and beverage brands at Procter & Gamble, as the new CEO for the next 10 years until it merged with JAB in 2012. O'Dea implemented a direct store delivery sales and distribution system, further driving the company's growth.<sup>109</sup> Another notable shift in the business was that when Baldwin and his partners purchased Peet's, about 25% to 30% of sales came from coffee accessories like coffee makers, but now that figure has likely dropped to around 1%, according to Baldwin.<sup>110</sup>

In July 2012, Peet's and JAB Holdings entered into a merger agreement in which JAB acquired all outstanding shares of Peet's common stock for \$73.50 per share in cash.<sup>111</sup> The total transaction amounted to \$977.6 million,<sup>112</sup> with an estimated P/E ratio of 67.1x.

Expanding into China has been pivotal for Starbucks, leveraging the country's vast population and rapid urbanization to drive significant and continuous growth. By 2009, a decade after entering the Chinese market, Starbucks had established 474 stores, both company-operated and licensed, constituting 3% of its global store count, as Figure 20-2 shows. While specific sales figures for China were not disclosed, comparable sales in the China/Asia Pacific region outpaced the company's overall growth from 2008 to 2015, as Figure 20-3 shows. Over time, these sales trends gradually align with those of U.S. stores as the company expands its presence in China.

By the end of 2023, Starbucks had expanded its presence in China even further, with 6,804 company-operated stores accounting for 18% of its global footprint, or 35% of its total company-operated stores. China emerged as Starbucks' largest market outside of the U.S., where it operates 49% of its total company-operated stores. In FY 2012, net revenue from China/Asia Pacific reached \$721.4 million, contributing 5% to the company's overall revenue. By fiscal year 2023, China alone generated nearly \$3.1 billion in net revenue, comprising 9% of the company's overall revenue, following closely behind the U.S. at \$26 billion, or 73%.

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<sup>104</sup> Discussion with Jerry Baldwin.

<sup>105</sup> Discussion with Jerry Baldwin.

<sup>106</sup> Discussion with Jerry Baldwin.

<sup>107</sup> Discussion with Jerry Baldwin.

<sup>108</sup> Discussion with Jerry Baldwin.

<sup>109</sup> Discussion with Jerry Baldwin; Peet's Annual Report 2002.

<sup>110</sup> Discussion with Jerry Baldwin.

<sup>111</sup> Peet's 10-Q 7/1/2012.

<sup>112</sup> Investor JAB merges Peet's Coffee. <https://www.reuters.com/article/markets/commodities/investor-jab-merges-peets-coffee-douwe-egberts-ahead-of-listing-idUSL8N28R4DN/#:~:text=JAB%20bought%20Peet's%20in%202012,Mondelez%20International%20to%20create%20JDE>

Various studies indicate that coffee has gained popularity in China, particularly in top-tier cities as urbanization progresses. According to a 2021 Deloitte study, although coffee drinkers in tier-one and tier-two cities typically consumed around 300 cups of coffee annually,<sup>113</sup> China's national average per capita consumption was only 9 cups, compared to 329 cups in the U.S.. Even in also traditionally tea-drinking countries like Japan and Korea, coffee consumption reached 280 and 367 cups, respectively. Deloitte anticipates that with the influence of first-tier and second-tier cities, coffee marketing education will expand to other urban areas, transforming coffee from a "trendy drink" to a "daily drink". China's coffee market has experienced rapid growth, with China Daily reporting that national average per capita annual coffee consumption nearly doubled to 16.74 cups in 2023<sup>114</sup> since 2016. In 2021, Shanghai had nearly 7,000 coffee shops and became the city with the most coffee shops in the world.<sup>115</sup> Furthermore, in 2023, the World Coffee Portal revealed that China surpassed the U.S. to become the country with the highest number of branded coffee shops globally, with nearly 50,000 outlets and with continuous expansion.<sup>116</sup> Despite this growth, Starbucks holds less than 15% of the market share in China in terms of the number of coffee shops as of 2023, indicating substantial potential for further expansion.

Starbucks has consistently emphasized China as its next growth driver, reaffirming its long-term commitment to expansion in this rapidly growing market. In 2017, Starbucks acquired full ownership of stores in China from its East China joint venture partner for \$1.3 billion,<sup>117</sup> the largest acquisition that the company had done, with then-CEO Kevin Johnson stating, "Unifying the Starbucks business under a full company-operated structure in China reinforces our commitment to the market and is a firm demonstration of our confidence in the current local leadership team. This is a critical next step as we advance our multifaceted China growth strategy for long-term profitable growth in Asia" Johnson reiterated in 2018, "We continue to mindfully evolve a coffee culture in China where the reward will be healthy, long-term, profitable growth for decades to come. We are committed to long-term investment in China."<sup>118</sup> In 2022, the company announced its ambitious goal of operating 9,000 stores in China by 2025, equivalent to opening one store every nine hours.<sup>119</sup>

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<sup>113</sup> White Paper on China's Freshly Brewed Coffee Industry. Deloitte China. April 2021.

<sup>114</sup> Shanghai pushes China's coffee industry to nearly \$40b.

<https://www.chinadaily.com.cn/a/202405/01/WS6631eea3a31082fc043c5022.html>

<sup>115</sup> Shanghai Becomes World's Most Cafe-Crowded City. <https://asia.nikkei.com/Business/Food-Beverage/Shanghai-becomes-world-s-most-cafe-crowded-city>

<sup>116</sup> China: 1.4 billion Reasons To Sell Coffee. <https://www.worldcoffeeportal.com/Latest/InsightAnalysis/2024/March/China-1-4-billion-reasons-to-sell-coffee#:~:text=In%20December%202023%20World%20Coffee,1.4%20billion%20citizens%20are%20undeniable.>

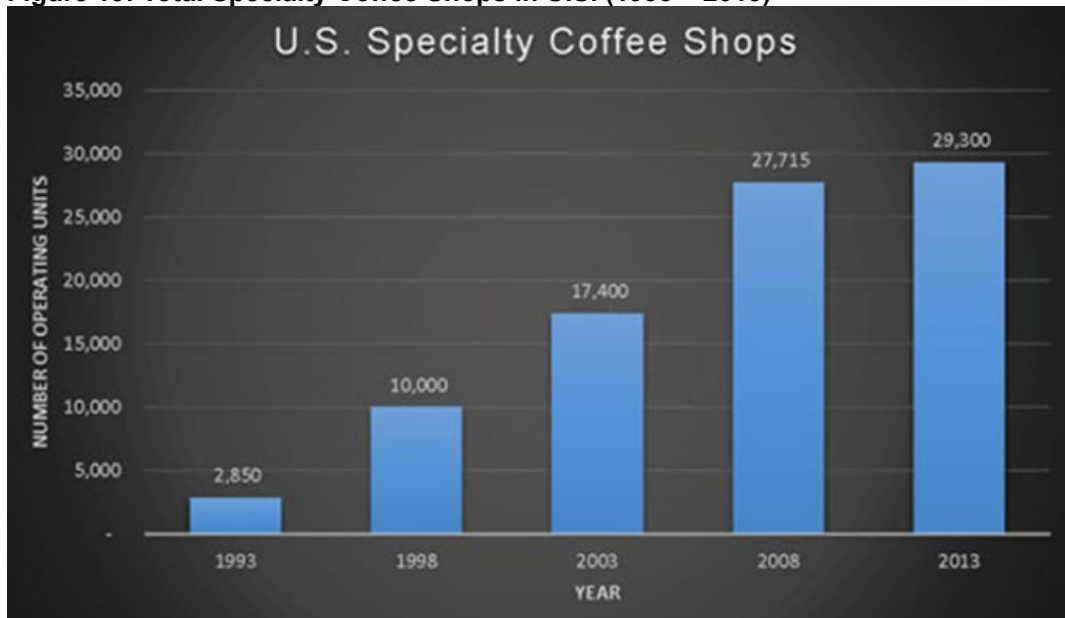
<sup>117</sup> Starbucks to own 100% of its China stores after buyout deal. <https://www.bbc.com/news/business-40749055>

<sup>118</sup> Starbucks First-Ever China Investor Conference Highlights Store Growth in its Fastest Growing Market.

<https://stories.starbucks.com/press/2018/starbucks-china-investor-conference/>

<sup>119</sup> Starbucks to open one store nearly every nine hours in China for next three years. <https://chainstoreage.com/starbucks-open-one-store-nearly-every-nine-hours-china-next-three-years>

Figure 19: Total Specialty Coffee Shops in U.S. (1993 – 2013)<sup>120</sup>



Note:

1. Special Coffee Association defines specialty coffee shops in the above chart as businesses deriving 55% or more of total revenue from the sale of coffee, coffee beverages, and coffee accessories.

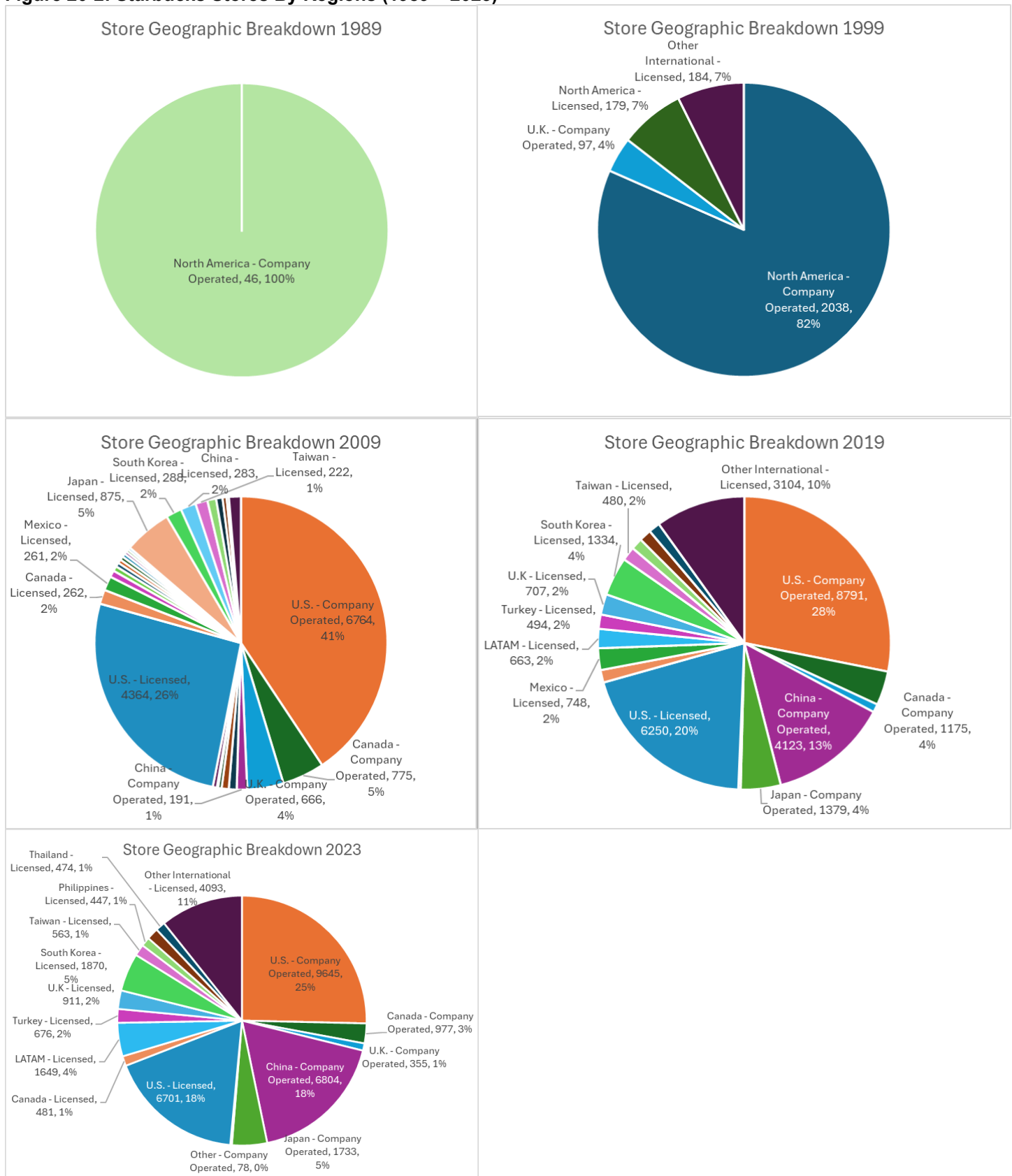
Figure 20-1: Starbucks Stores (1987-2023)



Notes:

1. The numbers of stores each year are provided in the company's annual reports and prospectus.
2. The company claims in its prospectus that it had 11 stores at the end of fiscal 1987. It claims that it had 17 stores at the end of fiscal 1987 in its 1994 annual report.

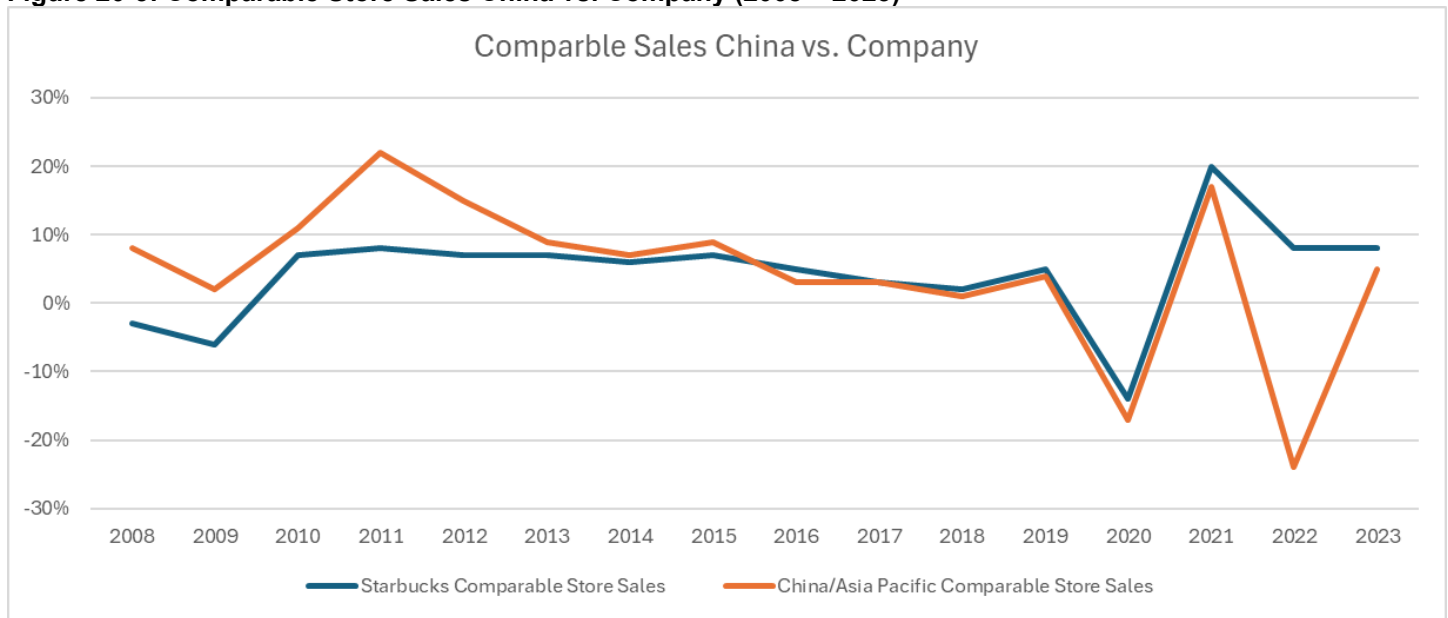
**Figure 20-2: Starbucks Stores By Regions (1989 – 2023)**



**Notes:**

1. Stores above include both company-operated and licensed stores.
2. Starbucks acquired licensed stores by 2017, and since then, all stores in China have been company-operated.

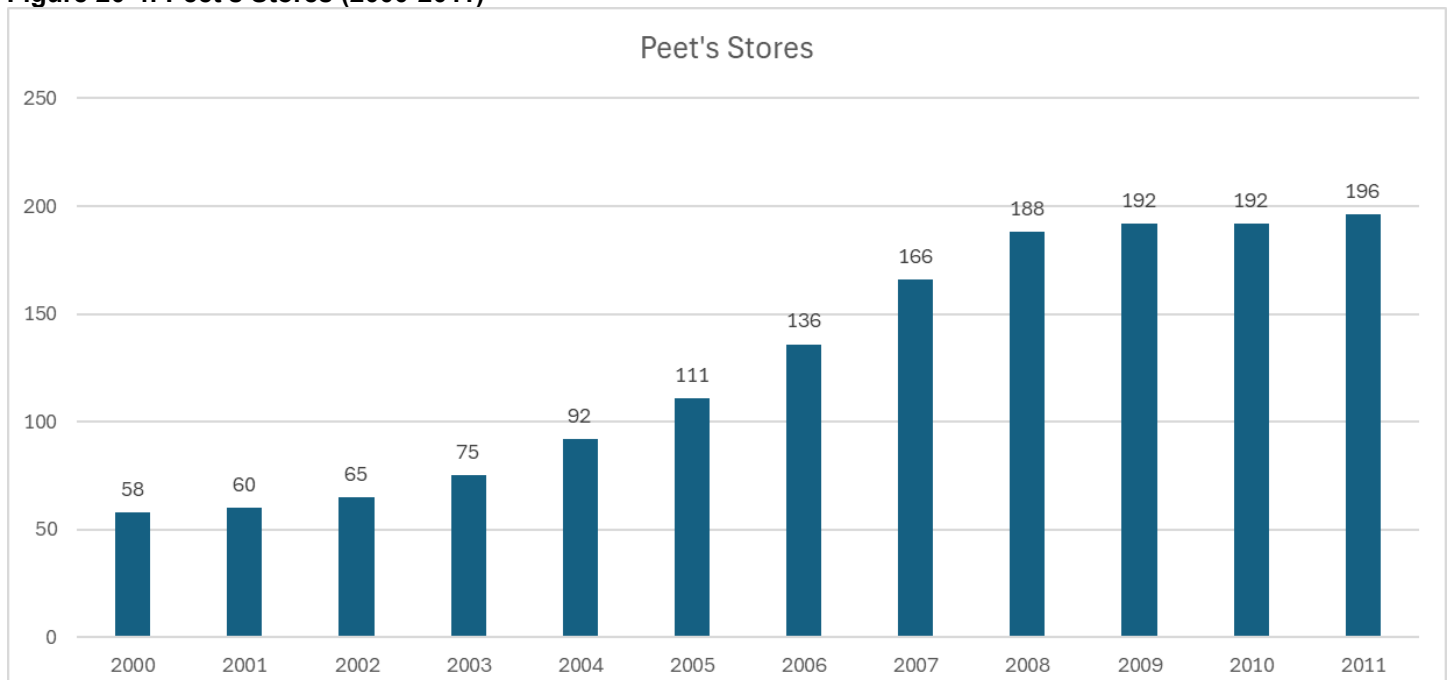
**Figure 20-3: Comparable Store Sales China vs. Company (2008 – 2023)<sup>121</sup>**



**Notes:**

1. Comparable store sales growth of China for 2019, 2020, and 2023 was from earnings release and earnings call
2. From FY2020 to FY2023, China experienced a series of lockdowns nationwide related to the COVID-19. The country fully lifted COVID restrictions in the beginning of 2023.
3. Decline in 2022 was due to COVID-19 restrictions in China that severely impacted customer mobility.

**Figure 20-4: Peet's Stores (2000-2011)<sup>122</sup>**



Peet's Coffee & Tea	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Stores	58	60	65	75	92	111	136	166	188	192	192	196

**Notes:**

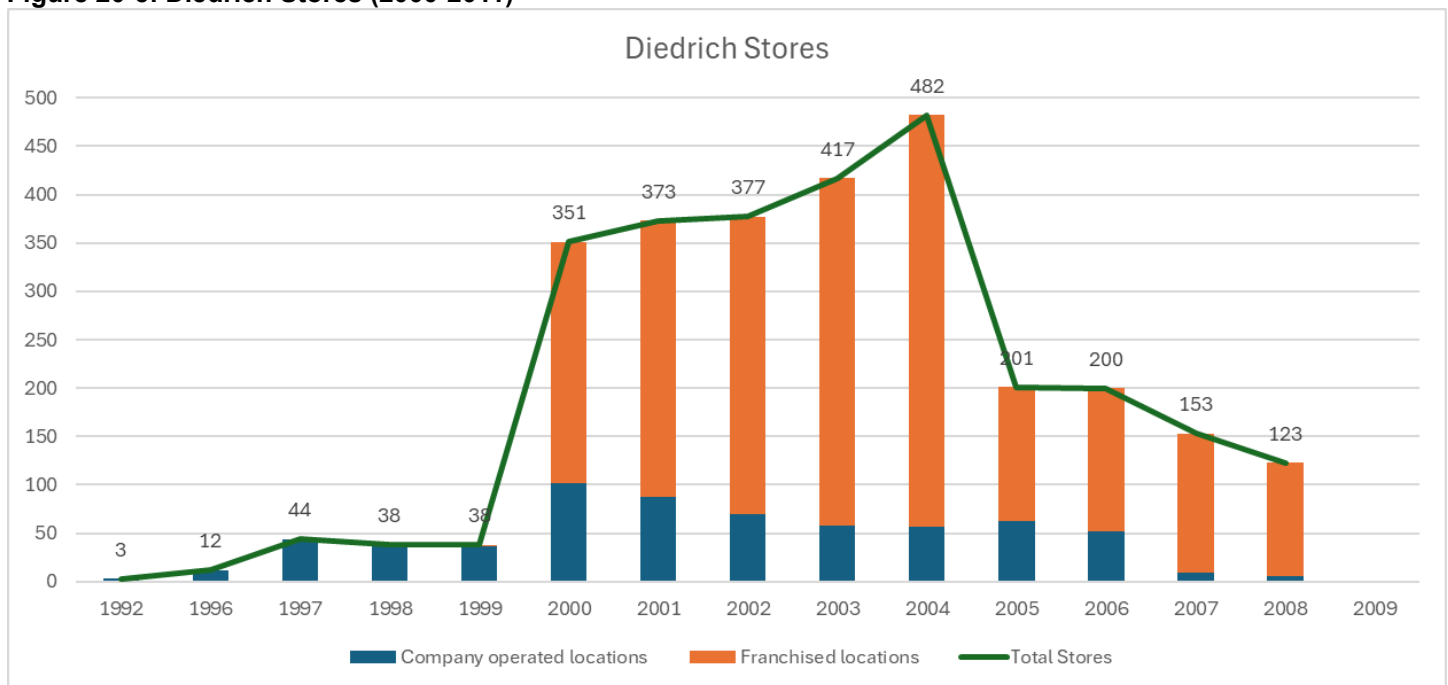
1. Peet's went public in 2001 and was taken private in 2012.

<sup>121</sup> Starbucks Annual Report 2012 – 2023; Earnings Release in Q4 FY2019 and FY2020; Q4 2023 Earnings Call.

<sup>122</sup> Peet's Annual Reports 2001-2011, and Investor Slide May 2012.

2. Peet's operated only in the U.S. across 6 states as of FY2011 with over 170 in California.<sup>123</sup>

**Figure 20-5: Diedrich Stores (2000-2011)**



**Notes:**

1. In 2000, Diedrich acquired Coffee People and its 278 Gloria Jean's mall coffee shops.
2. In 2005, Diedrich sold Gloria Jean's international franchise operations.
3. Starting in 2006, the company started to sell its retail business to other companies, including Starbucks, to focus on wholesale of coffee, and eventually was acquired by Green Mountain Coffee.

As Starbucks' brand image grew stronger through years of developing its self-operated stores and maintaining high standards at licensed locations, the company expanded into other areas that it had previously avoided to protect its brand reputation, such as partnerships with supermarkets and serving coffee on airplanes. Starbucks carefully selects partners known for their commitment to quality, reputation, and customer service. For example, in 1993, Starbucks began selling its coffee to Nordstrom and setting up kiosks in supermarkets that were considered high-quality in their markets.<sup>124</sup> Although specialty sales, including licensing, partnerships, and consumer packaged goods, have typically contributed less than 20% of the company's total revenue over the past two decades since 1989, as Figure 21 shows, they play an important role in expanding Starbucks' customer base, increasing brand awareness, and reinforcing customer loyalty.

In 1997, Starbucks launched a significant supermarket test of its whole bean and ground coffees in the Chicago area. This followed a smaller test conducted earlier that year in Portland, Oregon, which involved around 500 grocery stores.<sup>125</sup> The company introduced five new caffeinated blends and one decaffeinated blend, all available in both whole bean and ground forms. The packaging and merchandising were specifically designed to stand out on supermarket shelves, aiming to attract consumer attention.

The purpose of this test was to gauge consumer response and assess the potential impact on the company's retail business,<sup>126</sup> though Starbucks did not disclose the results. By 1998, the company expanded its coffee distribution to approximately 4,000 supermarkets across the U.S.<sup>127</sup> That same year, Starbucks entered into a long-term licensing agreement with Kraft Foods, aimed at accelerating the brand's growth in the U.S. grocery market. Under this agreement, Kraft took charge of distribution, marketing, advertising, and promotions for Starbucks' whole bean and ground coffee in grocery stores, warehouse clubs, and mass merchandise outlets.

<sup>123</sup> Peet's Annual Report 2011.

<sup>124</sup> Chapter 18, Pour Your Heart Into It.

<sup>125</sup> Starbucks Annual Report 1997.

<sup>126</sup> Starbucks Annual Report 1997.

<sup>127</sup> Starbucks Annual Report 1998.

Starbucks' management recognized that the supermarket channel posed a significant competitive challenge in the whole bean coffee market. Supermarkets offered customers the convenience of purchasing coffee without needing to visit a Starbucks store.<sup>128</sup> This convenience factor was likely one of the reasons Starbucks decided to enter the supermarket space—not only to increase brand exposure but also to capture this group of customers who might otherwise choose a competitor's product. Major coffee manufacturers like Kraft General Foods, Procter & Gamble, and Nestlé were already distributing premium coffee products in supermarkets, which could easily serve as substitutes for Starbucks' offerings.

In our discussion with him, Jerry Baldwin expressed surprise that these major roasters had not used their distribution efficiency to outcompete Starbucks and Peet's when they were still small companies.<sup>129</sup> He noted that Maxwell House, owned by General Foods at the time, had introduced a private collection of whole bean coffee in supermarkets as early as the 1980s, and Kraft owned Gevalia, which operated on a subscription model. Baldwin referenced a colleague from Peet's, who had previously worked in marketing at General Foods, and mentioned that Maxwell House's private label collections were simply too small for the company.

Besides the supermarket channel, company partnerships were a large co-branding opportunity for consumers to conveniently try Starbucks coffee. Airlines were notorious for serving low-quality coffee due to limited space and equipment constraints. However, airlines also serve tens of millions of people every day, making them an attractive opportunity for brand exposure. In 1996, Starbucks began serving its coffee on United Airlines, which operated thousands of flights daily with over 20 million passengers annually. To ensure the coffee served on flights met Starbucks' quality standards, the company required United Airlines to maintain those standards, providing training to flight attendants on coffee knowledge, Starbucks' values, and history to answer customer questions effectively. Starbucks also retrofitted the brewing equipment used on flights to ensure consistent coffee quality. Though the exact sales figures from airline partnerships are unknown, these collaborations undoubtedly helped broaden Starbucks' customer base and increase brand visibility. In 1996, United Airlines placed ads on the back covers of major national magazines such as Business Week, Time, and U.S. News & World Report, giving Starbucks not only national advertising exposure but also the endorsement of the country's largest airline with millions of customers.<sup>130</sup> These strategic moves allowed Starbucks to expand into new businesses while maintaining its reputation for quality and customer service.

**“A survey we conducted in April 1996 indicated that 71 percent of coffee drinkers on United described the coffee as excellent or good overall. About 14 percent had tasted their first Starbucks coffee on United. While some said the in-flight coffee was not quite as good as what they had bought at Starbucks stores, a large majority of passengers said that it was better than that of other airlines”.**<sup>131</sup>

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<sup>128</sup> Starbucks Annual Report 1996.

<sup>129</sup> Discussion with Jerry Baldwin.

<sup>130</sup> Chapter 18, Pour Your Heart Into It.

<sup>131</sup> Chapter 18, Pour Your Heart Into It.

**Figure 21: Pro-Forma Income Statement (1987 – 2023)**

(\$Million, except for per share data)	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Comparable Store Sales				22.6%	15.3%	20.8%	20.2%	9.0%	9.0%	7.0%	5.0%	5.0%	6.0%
Number of Stores	11	26	46	75	107	154	253	425	676	1,006	1,381	1,886	2,498
Company-operated stores	1.0	8.1	15.6	30.0	50.0	81.1	142.4	248.5	402.7	600.1	828.1	1,102.6	1,423.4
Licensing	-	-	-	-	-	-	-	-	-	-	-	-	-
Food service and other	0.2	2.2	3.6	5.4	7.6	12.0	21.1	36.4	62.6	96.4	138.9	206.1	256.8
Total specialty	0.2	2.2	3.6	5.4	7.6	12.0	21.1	36.4	62.6	96.4	138.9	206.1	256.8
<b>Total Revenue</b>	<b>1.3</b>	<b>10.2</b>	<b>19.2</b>	<b>35.4</b>	<b>57.7</b>	<b>93.1</b>	<b>163.5</b>	<b>284.9</b>	<b>465.2</b>	<b>696.5</b>	<b>966.9</b>	<b>1,308.7</b>	<b>1,680.1</b>
<b>Gross Income</b>	<b>0.6</b>	<b>4.4</b>	<b>8.4</b>	<b>18.1</b>	<b>31.2</b>	<b>51.6</b>	<b>89.9</b>	<b>157.7</b>	<b>253.9</b>	<b>360.7</b>	<b>534.8</b>	<b>730.2</b>	<b>939.1</b>
Gross Margin	46.2%	42.9%	43.8%	51.1%	54.2%	55.4%	55.0%	55.3%	54.6%	51.8%	55.3%	55.8%	55.9%
YoY Growth		647.3%	92.2%	115.0%	72.6%	65.1%	74.4%	75.4%	61.1%	42.0%	48.3%	36.6%	28.6%
Store operating expenses	0.3	2.7	5.2	10.5	19.4	31.2	53.3	93.2	148.8	210.7	309.1	418.5	543.6
Store operating expenses as % of Sales	26.2%	26.4%	27.2%	29.7%	33.6%	33.6%	32.6%	32.7%	32.0%	30.3%	32.0%	32.0%	32.4%
G&A Expense	0.5	1.4	2.4	4.1	4.9	8.1	12.5	20.0	28.6	37.3	57.1	77.6	89.7
G&A expenses as % of Sales	40.1%	13.2%	12.3%	11.7%	8.5%	8.7%	7.6%	7.0%	6.2%	5.3%	5.9%	5.9%	5.3%
<b>EBIT</b>	<b>(0.4)</b>	<b>(0.6)</b>	<b>(0.8)</b>	<b>0.8</b>	<b>2.9</b>	<b>6.4</b>	<b>13.0</b>	<b>23.3</b>	<b>40.1</b>	<b>57.0</b>	<b>88.2</b>	<b>109.2</b>	<b>156.7</b>
EBIT Margin	-29.2%	-6.2%	-4.3%	2.3%	5.0%	6.8%	7.9%	8.2%	8.6%	8.2%	9.1%	8.3%	9.3%
YoY Growth					260.9%	119.0%	103.7%	79.6%	72.2%	42.1%	54.8%	23.8%	43.5%
<b>EBITDA</b>	<b>(0.3)</b>	<b>(0.0)</b>	<b>0.4</b>	<b>2.6</b>	<b>5.8</b>	<b>10.5</b>	<b>19.8</b>	<b>37.3</b>	<b>64.9</b>	<b>96.4</b>	<b>146.4</b>	<b>190.1</b>	<b>264.2</b>
EBITDA Margin	-21.7%	-0.4%	0.8%	6.5%	9.4%	10.8%	11.7%	12.6%	13.5%	13.3%	14.5%	13.9%	15.1%
YoY Growth				620.0%	122.1%	79.9%	88.6%	88.4%	74.1%	48.4%	52.0%	29.8%	39.0%
<b>Net Income</b>	<b>(0.3)</b>	<b>(0.8)</b>	<b>(1.2)</b>	<b>0.0</b>	<b>0.9</b>	<b>1.5</b>	<b>8.5</b>	<b>9.9</b>	<b>26.1</b>	<b>42.1</b>	<b>57.4</b>	<b>68.4</b>	<b>101.7</b>
Net Margin	-26.0%	-7.5%	-6.1%	0.0%	1.6%	1.7%	5.2%	3.5%	5.6%	6.0%	5.9%	5.2%	6.1%
YoY Growth					5229.4%	69.9%	452.5%	16.9%	162.7%	61.4%	36.3%	19.1%	48.7%
EPS	-	-	-	0.0	0.2	0.3	0.29	0.3	0.4	0.6	0.7	0.8	0.6
YoY Growth						37.5%	-12.1%	17.2%	8.8%	48.6%	27.3%	11.4%	-28.2%
Average Shares Outstanding	10.2	4.1	4.1	4.1	4.2	12.4	29.0	29.9	71.3	77.0	81.6	88.1	181.8
YoY Change						195.9%	133.4%	2.9%	138.7%	7.9%	6.1%	7.9%	106.5%
Dividends per Share	-	-	-	-	-	-	-	-	-	-	-	-	-
YoY Growth													
(\$Million, except for per share data)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Comparable Store Sales	9.0%	5.0%	6.0%	8.0%	10.0%	8.0%	7.0%	5.0%	-3.0%	-6.0%	7.0%	8.0%	7.0%
Number of Stores	3,501	4,709	5,886	7,225	8,569	10,241	12,440	15,011	16,680	16,635	16,858	17,003	18,066
Company-operated stores	1,823.6	2,229.6	2,792.9	3,449.6	4,457.4	5,391.9	6,583.1	7,998.3	8,771.9	8,180.1	8,963.5	9,632.4	10,534.5
Licensing	189.4	240.7	311.9	409.6	565.8	673.0	860.7	1,026.3	1,171.6	1,222.3	1,340.9	1,007.5	1,210.3
Food service and other	164.6	178.7	184.1	216.3	271.1	304.4	343.2	386.9	439.5	372.2	403.0	1,060.5	1,554.7
Total specialty	354.0	419.4	496.0	625.9	836.9	977.4	1,203.8	1,413.2	1,611.1	1,594.5	1,743.9	2,068.0	2,765.0
<b>Total Revenue</b>	<b>2,177.6</b>	<b>2,649.0</b>	<b>3,288.9</b>	<b>4,075.5</b>	<b>5,294.2</b>	<b>6,369.3</b>	<b>7,786.9</b>	<b>9,411.5</b>	<b>10,383.0</b>	<b>9,774.6</b>	<b>10,707.4</b>	<b>11,700.4</b>	<b>13,299.5</b>
<b>Gross Income</b>	<b>1,224.1</b>	<b>1,536.2</b>	<b>1,938.9</b>	<b>2,389.6</b>	<b>3,095.6</b>	<b>3,764.1</b>	<b>4,608.2</b>	<b>5,412.4</b>	<b>5,737.7</b>	<b>5,449.7</b>	<b>6,248.8</b>	<b>6,751.1</b>	<b>7,486.2</b>
Gross Margin	56.2%	58.0%	59.0%	58.6%	58.5%	59.1%	59.2%	57.5%	55.3%	55.8%	58.4%	57.7%	56.3%
YoY Growth	30.3%	25.5%	26.2%	23.2%	29.5%	21.6%	22.4%	17.5%	6.0%	-5.0%	14.7%	8.0%	10.9%
Store operating expenses	704.9	875.5	1,121.1	1,379.6	1,790.2	2,165.9	2,687.8	3,215.9	3,745.1	3,425.1	3,551.4	3,665.1	3,918.1
Store operating expenses as % of Sales	32.4%	33.0%	34.1%	33.9%	33.8%	34.0%	34.5%	34.2%	36.1%	35.0%	33.2%	31.3%	29.5%
G&A Expense	110.2	151.4	202.2	244.6	304.3	357.1	473.0	489.2	456.0	453.0	569.5	636.1	801.2
G&A expenses as % of Sales	5.1%	5.7%	6.1%	6.0%	5.7%	5.6%	6.1%	5.2%	4.4%	4.6%	5.3%	5.4%	6.0%
<b>EBIT</b>	<b>220.6</b>	<b>281.1</b>	<b>318.7</b>	<b>424.7</b>	<b>610.1</b>	<b>780.6</b>	<b>894.0</b>	<b>1,053.9</b>	<b>503.9</b>	<b>562.0</b>	<b>1,419.4</b>	<b>1,728.5</b>	<b>1,997.4</b>
EBIT Margin	10.1%	10.6%	9.7%	10.4%	11.5%	12.3%	11.5%	11.2%	4.9%	5.7%	13.3%	14.8%	15.0%
YoY Growth	40.8%	27.4%	13.4%	33.3%	43.7%	27.9%	14.5%	17.9%	-52.2%	11.5%	152.6%	21.8%	15.6%
<b>EBITDA</b>	<b>362.8</b>	<b>458.2</b>	<b>539.9</b>	<b>684.0</b>	<b>924.2</b>	<b>1,147.8</b>	<b>1,306.6</b>	<b>1,545.2</b>	<b>1,108.4</b>	<b>1,125.3</b>	<b>1,960.2</b>	<b>2,278.5</b>	<b>2,578.0</b>
EBITDA Margin	16.1%	16.8%	15.9%	16.3%	16.8%	17.6%	16.5%	16.2%	10.1%	11.2%	18.0%	19.2%	19.2%
YoY Growth	37.3%	26.3%	17.8%	26.7%	35.1%	24.2%	13.8%	18.3%	-28.3%	1.5%	74.2%	16.2%	13.1%
<b>Net Income</b>	<b>103.0</b>	<b>181.2</b>	<b>215.1</b>	<b>268.3</b>	<b>391.8</b>	<b>494.5</b>	<b>564.3</b>	<b>672.6</b>	<b>315.5</b>	<b>390.8</b>	<b>945.6</b>	<b>1,245.7</b>	<b>1,383.8</b>
Net Margin	4.7%	6.8%	6.5%	6.6%	7.4%	7.8%	7.2%	7.1%	3.0%	4.0%	8.8%	10.6%	10.4%
YoY Growth	1.2%	76.0%	18.7%	24.8%	46.0%	26.2%	14.1%	19.2%	-53.1%	23.9%	142.0%	31.7%	11.1%
EPS	0.5	0.5	0.6	0.7	1.0	0.6	0.7	0.9	0.4	0.5	1.3	1.7	1.8
YoY Growth	-8.9%	-5.9%	16.7%	23.2%	43.5%	-36.4%	17.5%	21.6%	-52.2%	23.3%	139.6%	30.7%	10.2%
Average Shares Outstanding	185.6	380.6	385.6	390.8	397.2	789.6	766.1	749.8	731.5	738.7	744.4	748.3	754.4
YoY Change	2.1%	105.1%	1.3%	1.3%	1.6%	98.8%	-3.0%	-2.1%	-2.4%	1.0%	0.8%	0.5%	0.8%
Dividends per Share	-	-	-	-	-	-	-	-	-	-	0.4	0.6	0.7
YoY Growth												55.6%	28.6%

(\$Million, except for per share data)	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Comparable Store Sales	7.0%	6.0%	7.0%	5.0%	3.0%	2.0%	5.0%	-14.0%	20.0%	8.0%	8.0%
Number of Stores	19,767	21,366	23,043	25,085	27,339	29,324	31,256	32,660	33,833	35,711	38,038
<b>Company-operated stores</b>	<b>11,793.2</b>	<b>12,977.9</b>	<b>15,197.3</b>	<b>16,844.1</b>	<b>17,650.7</b>	<b>19,690.3</b>	<b>21,544.4</b>	<b>19,164.6</b>	<b>24,607.0</b>	<b>26,576.1</b>	<b>29,462.3</b>
Licensing	1,360.5	1,588.6	1,861.9	2,154.2	2,355.0	2,652.2	2,875.0	2,327.1	2,683.6	3,655.5	4,512.7
Food service and other	1,738.5	1,881.3	2,103.5	2,317.6	2,381.1	2,377.0	2,089.2	2,026.3	1,770.0	2,018.7	2,000.6
Total specialty	3,099.0	3,469.9	3,965.4	4,471.8	4,736.1	5,029.2	4,964.2	4,353.4	4,453.6	5,674.2	6,513.3
<b>Total Revenue</b>	<b>14,892.2</b>	<b>16,447.8</b>	<b>19,162.7</b>	<b>21,315.9</b>	<b>22,386.8</b>	<b>24,719.5</b>	<b>26,508.6</b>	<b>23,518.0</b>	<b>29,060.6</b>	<b>32,250.3</b>	<b>35,975.6</b>
<b>Gross Income</b>	<b>8,509.9</b>	<b>9,589.0</b>	<b>11,375.2</b>	<b>12,804.8</b>	<b>13,348.6</b>	<b>14,545.0</b>	<b>17,981.7</b>	<b>15,823.1</b>	<b>20,321.9</b>	<b>21,932.9</b>	<b>24,566.5</b>
Gross Margin	57.1%	58.3%	59.4%	60.1%	59.6%	58.8%	67.8%	67.3%	69.9%	68.0%	68.3%
YoY Growth	13.7%	12.7%	18.6%	12.6%	4.2%	9.0%	23.6%	-12.0%	28.4%	7.9%	12.0%
<b>Store operating expenses</b>	<b>4,286.1</b>	<b>4,638.2</b>	<b>5,411.1</b>	<b>6,064.3</b>	<b>6,493.3</b>	<b>7,193.2</b>	<b>10,493.6</b>	<b>10,764.0</b>	<b>11,930.9</b>	<b>13,561.8</b>	<b>14,720.3</b>
Store operating expenses as % of Sales	28.8%	28.2%	28.2%	28.4%	29.0%	29.1%	39.6%	45.8%	41.1%	42.1%	40.9%
<b>G&amp;A Expense</b>	<b>937.9</b>	<b>991.3</b>	<b>1,196.7</b>	<b>1,360.6</b>	<b>1,393.3</b>	<b>1,759.0</b>	<b>1,824.1</b>	<b>1,679.6</b>	<b>1,932.6</b>	<b>2,032.0</b>	<b>2,441.3</b>
G&A expenses as % of Sales	6.3%	6.0%	6.2%	6.4%	6.2%	7.1%	6.9%	7.1%	6.7%	6.3%	6.8%
<b>EBIT</b>	<b>(325.4)</b>	<b>3,081.1</b>	<b>3,601.0</b>	<b>4,171.9</b>	<b>4,134.7</b>	<b>3,883.3</b>	<b>4,077.9</b>	<b>1,561.7</b>	<b>4,872.1</b>	<b>4,617.8</b>	<b>5,870.8</b>
EBIT Margin	-2.2%	18.7%	18.8%	19.6%	18.5%	15.7%	15.4%	6.6%	16.8%	14.3%	16.3%
YoY Growth	-116.3%	-1046.9%	16.9%	15.9%	-0.9%	-6.1%	5.0%	-61.7%	212.0%	-5.2%	27.1%
<b>EBITDA</b>	<b>330.2</b>	<b>3,829.5</b>	<b>4,534.8</b>	<b>5,202.0</b>	<b>5,201.8</b>	<b>5,189.2</b>	<b>5,527.2</b>	<b>3,064.9</b>	<b>6,396.2</b>	<b>6,147.2</b>	<b>7,321.1</b>
EBITDA Margin	2.0%	23.0%	23.5%	24.2%	23.0%	20.8%	20.6%	12.7%	21.7%	18.8%	20.1%
YoY Growth	-87.2%	1059.8%	18.4%	14.7%	0.0%	-0.2%	6.5%	-44.5%	108.7%	-3.9%	19.1%
<b>Net Income</b>	<b>8.3</b>	<b>2,068.1</b>	<b>2,757.4</b>	<b>2,817.7</b>	<b>2,884.7</b>	<b>4,518.3</b>	<b>3,599.2</b>	<b>928.3</b>	<b>4,199.3</b>	<b>3,281.6</b>	<b>4,124.5</b>
Net Margin	0.1%	12.6%	14.4%	13.2%	12.9%	18.3%	13.6%	3.9%	14.5%	10.2%	11.5%
YoY Growth	-99.4%	24816.5%	33.3%	2.2%	2.4%	56.6%	-20.3%	-74.2%	352.4%	-21.9%	25.7%
<b>EPS</b>	<b>0.0</b>	<b>2.8</b>	<b>1.8</b>	<b>1.9</b>	<b>2.0</b>	<b>3.3</b>	<b>3.0</b>	<b>0.8</b>	<b>3.6</b>	<b>2.9</b>	<b>3.6</b>
YoY Growth	-99.5%	27400.0%	-33.1%	3.8%	4.2%	64.3%	-9.8%	-73.2%	351.9%	-20.2%	26.3%
<b>Average Shares Outstanding</b>	<b>749.3</b>	<b>753.1</b>	<b>1,495.9</b>	<b>1,471.6</b>	<b>1,449.5</b>	<b>1,382.7</b>	<b>1,221.2</b>	<b>1,172.8</b>	<b>1,177.6</b>	<b>1,153.3</b>	<b>1,146.8</b>
YoY Change	-0.7%	0.5%	98.6%	-1.6%	-1.5%	-4.6%	-11.7%	-4.0%	0.4%	-2.1%	-0.6%
<b>Dividends per Share</b>	<b>0.9</b>	<b>1.1</b>	<b>0.7</b>	<b>0.9</b>	<b>1.1</b>	<b>1.3</b>	<b>1.5</b>	<b>1.2</b>	<b>2.3</b>	<b>2.0</b>	<b>2.2</b>
YoY Growth	23.6%	23.6%	-38.2%	25.0%	23.5%	25.7%	12.9%	-17.4%	86.2%	-12.7%	8.0%

**Figure 22: Pro-Forma FCF (1989 – 2023)**

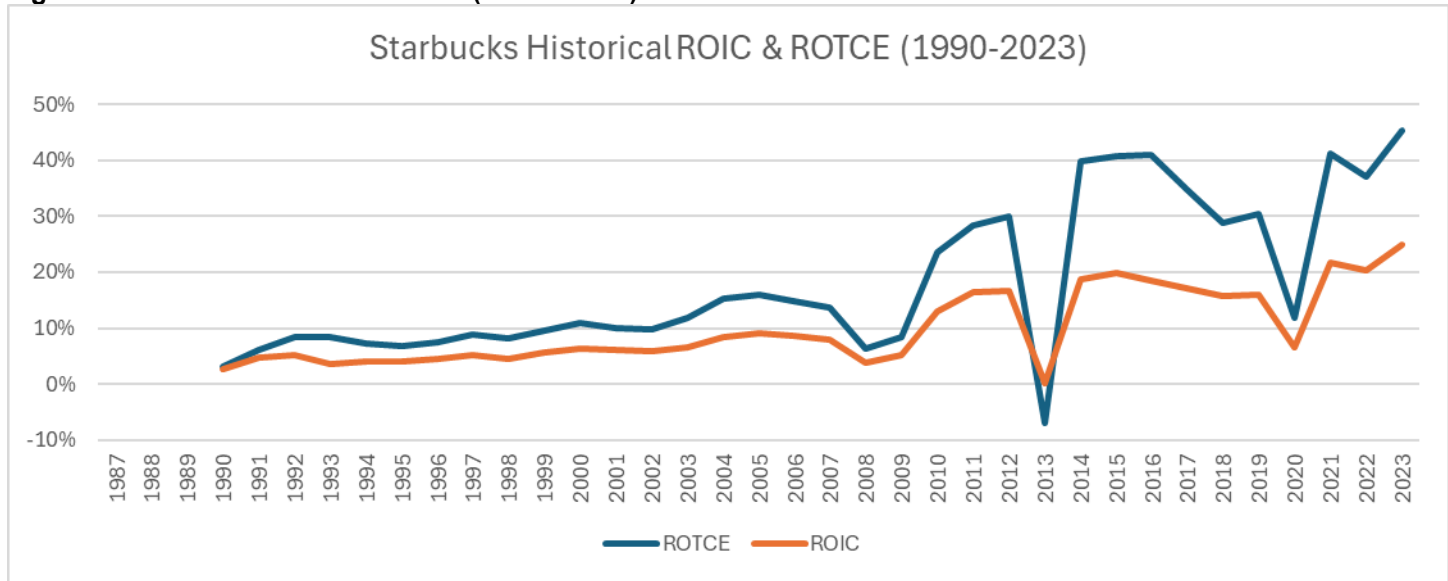
\$Million	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
EBIT	(0.8)	0.8	2.9	6.4	13.0	23.3	40.1	57.0	88.2	109.2	156.7	220.6
(-)Tax	-	-	0.5	2.5	5.4	7.5	17.0	26.4	35.9	48.0	62.3	66.0
EBIAT	(0.8)	0.8	2.4	3.9	7.6	15.8	23.1	30.6	52.3	61.2	94.4	154.6
(+)D&A	1.2	1.8	2.9	4.1	6.8	14.0	24.8	39.4	58.2	80.9	107.5	142.2
(-)CAPX	4.6	7.1	10.6	15.9	39.5	85.3	129.4	161.8	169.7	201.9	261.8	316.5
(-)Change in NWC	(0.1)	(0.5)	2.9	0.1	5.7	27.3	42.4	(57.6)	23.8	16.9	(0.4)	(19.6)
<b>Unlevered FCF</b>	<b>(4.1)</b>	<b>(4.0)</b>	<b>(8.1)</b>	<b>(8.0)</b>	<b>(30.9)</b>	<b>(82.8)</b>	<b>(123.8)</b>	<b>(34.2)</b>	<b>(82.9)</b>	<b>(76.6)</b>	<b>(59.5)</b>	<b>(0.1)</b>
YoY Growth	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A
CFO	0.1	3.3	2.6	8.9	9.0	(1.5)	12.6	136.7	101.0	142.9	210.6	318.6
less CAPX	4.6	7.1	10.6	15.9	39.5	85.3	129.4	161.8	169.7	201.9	261.8	316.5
<b>Levered FCF</b>	<b>(4.5)</b>	<b>(3.8)</b>	<b>(8.0)</b>	<b>(7.0)</b>	<b>(30.5)</b>	<b>(86.8)</b>	<b>(116.8)</b>	<b>(25.1)</b>	<b>(68.7)</b>	<b>(59.0)</b>	<b>(51.2)</b>	<b>2.1</b>
YoY Growth	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A
Net Income	(1.2)	0.0	0.9	1.5	8.5	9.9	26.1	42.1	57.4	68.4	101.7	103.0
(+)D&A	1.2	1.8	2.9	4.1	6.8	14.0	24.8	39.4	58.2	80.9	107.5	142.2
(-)CAPX	4.6	7.1	10.6	15.9	39.5	85.3	129.4	161.8	169.7	201.9	261.8	316.5
(-)Change in NWC	(0.1)	(0.5)	2.9	0.1	5.7	27.3	42.4	(57.6)	23.8	16.9	(0.4)	(19.6)
<b>Owner's Earnings</b>	<b>(4.5)</b>	<b>(4.8)</b>	<b>(9.6)</b>	<b>(10.3)</b>	<b>(29.9)</b>	<b>(88.6)</b>	<b>(120.8)</b>	<b>(22.7)</b>	<b>(77.8)</b>	<b>(69.5)</b>	<b>(52.1)</b>	<b>(51.8)</b>
YoY Growth	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A

<i>\$Million</i>	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
EBIT	281.1	318.7	424.7	610.1	780.6	894.0	1,053.9	503.9	562.0	1,419.4	1,728.5	1,997.4
(-)Tax	107.7	126.3	168.0	232.5	302.0	324.8	383.7	144.0	168.4	488.7	563.1	674.4
EBIAT	173.4	192.4	256.7	377.6	478.6	569.2	670.2	359.9	393.6	930.7	1,165.4	1,323.0
(+)D&A	177.1	221.1	259.3	314.0	367.2	412.6	491.2	604.5	563.3	540.8	550.0	580.6
(-CAPX)	384.1	375.5	357.3	412.5	644.0	771.2	1,080.3	984.5	445.6	440.7	531.9	856.2
(-)Change in NWC	(79.4)	(11.8)	(17.2)	(64.2)	28.3	(221.9)	(159.3)	(75.5)	(230.8)	(132.4)	248.1	404.0
<b>Unlevered FCF</b>	<b>45.8</b>	<b>49.9</b>	<b>175.9</b>	<b>343.3</b>	<b>173.5</b>	<b>432.5</b>	<b>240.4</b>	<b>55.4</b>	<b>742.1</b>	<b>1,163.2</b>	<b>935.4</b>	<b>643.4</b>
YoY Growth	#N/A	9%	252%	95%	-49%	149%	-44%	-77%	1240%	57%	-20%	-31%
CFO	460.8	477.7	566.4	820.2	923.6	1,131.6	1,331.2	1,258.7	1,389.0	1,704.9	1,612.4	1,750.3
less CAPX	384.1	375.5	357.3	412.5	644.0	771.2	1,080.3	984.5	445.6	440.7	531.9	856.2
<b>Levered FCF</b>	<b>76.7</b>	<b>102.2</b>	<b>209.2</b>	<b>407.7</b>	<b>279.6</b>	<b>360.4</b>	<b>250.9</b>	<b>274.2</b>	<b>943.4</b>	<b>1,264.2</b>	<b>1,080.5</b>	<b>894.1</b>
YoY Growth	3511%	33%	105%	95%	-31%	29%	-30%	9%	244%	34%	-15%	-17%
Net Income	181.2	215.1	268.3	391.8	494.5	564.3	672.6	315.5	390.8	945.6	1,245.7	1,383.8
(+)D&A	177.1	221.1	259.3	314.0	367.2	412.6	491.2	604.5	563.3	540.8	550.0	580.6
(-CAPX)	384.1	375.5	357.3	412.5	644.0	771.2	1,080.3	984.5	445.6	440.7	531.9	856.2
(-)Change in NWC	(79.4)	(11.8)	(17.2)	(64.2)	28.3	(221.9)	(159.3)	(75.5)	(230.8)	(132.4)	248.1	404.0
<b>Owner's Earnings</b>	<b>53.6</b>	<b>72.6</b>	<b>187.5</b>	<b>357.5</b>	<b>189.4</b>	<b>427.6</b>	<b>242.8</b>	<b>11.0</b>	<b>739.3</b>	<b>1,178.1</b>	<b>1,015.7</b>	<b>704.2</b>
YoY Growth	#N/A	35%	158%	91%	-47%	126%	-43%	-95%	6621%	59%	-14%	-31%
<i>\$Million</i>	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
EBIT	(325.4)	3,081.1	3,601.0	4,171.9	4,134.7	3,883.3	4,077.9	1,561.7	4,872.1	4,617.8	5,870.8	
(-)Tax	(238.7)	1,092.0	1,143.7	1,379.7	1,432.6	1,262.0	871.6	239.7	1,156.6	948.5	1,277.2	
EBIAT	(86.7)	1,989.1	2,457.3	2,792.2	2,702.1	2,621.3	3,206.3	1,322.0	3,715.5	3,669.3	4,593.6	
(+)D&A	655.6	748.4	933.8	1,030.1	1,067.1	1,305.9	1,449.3	1,503.2	1,524.1	1,529.4	1,450.3	
(-CAPX)	1,151.2	1,160.9	1,303.7	1,440.3	1,519.4	1,976.4	1,806.6	1,483.6	1,470.0	1,841.3	2,333.6	
(-)Change in NWC	(476.7)	2,209.8	(278.8)	(353.0)	(89.7)	(6,913.7)	(1,648.7)	2,676.4	501.2	2,133.0	1,133.4	
<b>Unlevered FCF</b>	<b>(105.6)</b>	<b>(633.2)</b>	<b>2,366.2</b>	<b>2,735.0</b>	<b>2,339.5</b>	<b>8,864.5</b>	<b>4,497.7</b>	<b>(1,334.8)</b>	<b>3,268.4</b>	<b>1,224.4</b>	<b>2,576.9</b>	
YoY Growth	-116%	#N/A	#N/A	16%	-14%	279%	-49%	-130%	#N/A	-63%	110%	
CFO	2,908.3	607.8	3,749.1	4,575.1	4,174.3	11,937.8	5,047.0	1,597.8	5,989.1	4,397.3	6,008.7	
less CAPX	1,151.2	1,160.9	1,303.7	1,440.3	1,519.4	1,976.4	1,806.6	1,483.6	1,470.0	1,841.3	2,333.6	
<b>Levered FCF</b>	<b>1,757.1</b>	<b>(553.1)</b>	<b>2,445.4</b>	<b>3,134.8</b>	<b>2,654.9</b>	<b>9,961.4</b>	<b>3,240.4</b>	<b>114.2</b>	<b>4,519.1</b>	<b>2,556.0</b>	<b>3,675.1</b>	
YoY Growth	97%	-131%	#N/A	28%	-15%	275%	-67%	-96%	3857%	-43%	44%	
Net Income	8.3	2,068.1	2,757.4	2,817.7	2,884.7	4,518.3	3,599.2	928.3	4,199.3	3,281.6	4,124.5	
(+)D&A	655.6	748.4	933.8	1,030.1	1,067.1	1,305.9	1,449.3	1,503.2	1,524.1	1,529.4	1,450.3	
(-CAPX)	1,151.2	1,160.9	1,303.7	1,440.3	1,519.4	1,976.4	1,806.6	1,483.6	1,470.0	1,841.3	2,333.6	
(-)Change in NWC	(476.7)	2,209.8	(278.8)	(353.0)	(89.7)	(6,913.7)	(1,648.7)	2,676.4	501.2	2,133.0	1,133.4	
<b>Owner's Earnings</b>	<b>(10.6)</b>	<b>(554.2)</b>	<b>2,666.3</b>	<b>2,760.5</b>	<b>2,522.1</b>	<b>10,761.5</b>	<b>4,890.6</b>	<b>(1,728.5)</b>	<b>3,752.2</b>	<b>836.7</b>	<b>2,107.8</b>	
YoY Growth	-102%	#N/A	#N/A	4%	-9%	327%	-55%	-135%	#N/A	-78%	152%	

Figure 23-1: ROIC and ROTCE (1990 – 2023)

	Average	Median	Min.	Max
<b>ROTCE</b>	18.1%	11.8%	-7.0%	45.4%
<b>Incremental ROTCE</b>	39.2%	10.0%	-193.7%	583.2%
<b>ROIC</b>	9.9%	6.5%	0.2%	24.9%
<b>Incremental ROIC</b>	37.7%	16.7%	-78.6%	331.2%

**Figure 23-2: ROIC and ROTCE Chart (1990 – 2023)**



**Notes:**

1. The negative ROTCE and ROIC in 2013 was due to a one-time litigation charge of \$2.78 billion with Kraft.
2. In 2020, COVID-19 negatively impacted the operating income of the company.
3. Operating leases are added to the calculation because they represent tangible assets essential for Starbucks' operations. Prior to 2019, operating leases were not required to be included on the Balance Sheet under US GAAP.

**Figure 23-3: Return on Invested Capital (1990-2023)**

\$, millions	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
EBIT	\$ 0.8	\$ 2.9	\$ 6.4	\$ 13.0	\$ 23.3	\$ 40.1	\$ 57.0	\$ 88.2	\$ 109.2	\$ 156.7	\$ 220.6	\$ 281.1
EBIAT	\$ 0.8	\$ 2.4	\$ 4.0	\$ 7.9	\$ 13.4	\$ 24.3	\$ 35.1	\$ 54.3	\$ 64.2	\$ 97.2	\$ 134.5	\$ 176.3
Invested Capital	\$ 20.4	\$ 31.2	\$ 42.1	\$ 140.3	\$ 187.0	\$ 347.8	\$ 412.3	\$ 583.8	\$ 723.4	\$ 947.3	\$ 1,104.7	\$ 1,247.9
+Operating Lease	\$ 10	\$ 20	\$ 35	\$ 74	\$ 141	\$ 253	\$ 365	\$ 472	\$ 686	\$ 805	\$ 1,039	\$ 1,655
<b>ROIC</b>	<b>2.6%</b>	<b>4.7%</b>	<b>5.2%</b>	<b>3.7%</b>	<b>4.1%</b>	<b>4.0%</b>	<b>4.5%</b>	<b>5.1%</b>	<b>4.6%</b>	<b>5.5%</b>	<b>6.3%</b>	<b>6.1%</b>
<b>Incremental ROIC</b>	<b>15.1%</b>	<b>14.1%</b>	<b>4.0%</b>	<b>11.7%</b>	<b>6.8%</b>	<b>16.7%</b>	<b>11.2%</b>	<b>7.1%</b>	<b>14.7%</b>	<b>23.7%</b>	<b>29.2%</b>	

\$, millions	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
EBIT	\$ 318.7	\$ 424.7	\$ 610.1	\$ 780.6	\$ 894.0	\$ 1,053.9	\$ 503.9	\$ 562.0	\$ 1,419.4	\$ 1,728.5	\$ 1,997.4	\$ (325.4)
EBIAT	\$ 200.8	\$ 261.2	\$ 382.9	\$ 484.6	\$ 573.6	\$ 671.1	\$ 346.0	\$ 392.8	\$ 936.7	\$ 1,191.1	\$ 1,343.2	\$ 12.5
Invested Capital	\$ 1,428.6	\$ 1,771.8	\$ 1,892.9	\$ 2,257.8	\$ 2,740.4	\$ 3,460.6	\$ 3,874.3	\$ 3,329.9	\$ 3,157.1	\$ 3,233.9	\$ 3,972.4	\$ 2,905.6
+Operating Lease	\$ 2,011	\$ 2,259	\$ 2,609	\$ 3,097	\$ 3,893	\$ 5,017	\$ 5,098	\$ 4,389	\$ 4,084	\$ 4,058	\$ 4,060	\$ 4,586
<b>ROIC</b>	<b>5.8%</b>	<b>6.5%</b>	<b>8.5%</b>	<b>9.0%</b>	<b>8.6%</b>	<b>7.9%</b>	<b>3.9%</b>	<b>5.1%</b>	<b>12.9%</b>	<b>16.3%</b>	<b>16.7%</b>	<b>0.2%</b>
<b>Incremental ROIC</b>	<b>13.6%</b>	<b>17.6%</b>	<b>100.4%</b>	<b>27.9%</b>	<b>18.4%</b>	<b>13.5%</b>	<b>-78.6%</b>	<b>N/A</b>	<b>N/A</b>	<b>331.2%</b>	<b>20.6%</b>	<b>N/A</b>

\$, millions	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
EBIT	\$ 3,081.1	\$ 3,601.0	\$ 4,171.9	\$ 4,134.7	\$ 3,883.3	\$ 4,077.9	\$ 1,561.7	\$ 4,872.1	\$ 4,617.8	\$ 5,870.8
EBIAT	\$ 2,016.3	\$ 2,545.8	\$ 2,801.0	\$ 2,762.8	\$ 3,035.4	\$ 3,282.1	\$ 1,240.2	\$ 3,820.2	\$ 3,582.8	\$ 4,482.7
Invested Capital	\$ 5,870.4	\$ 7,181.2	\$ 7,919.4	\$ 7,454.0	\$ 9,884.3	\$ 10,293.8	\$ 19,084.3	\$ 17,622.2	\$ 17,567.7	\$ 17,999.3
+Operating Lease	\$ 4,958	\$ 5,670	\$ 7,285	\$ 8,614	\$ 9,354	\$ 10,231	\$ -	\$ -	\$ -	\$ -
<b>ROIC</b>	<b>18.6%</b>	<b>19.8%</b>	<b>18.4%</b>	<b>17.2%</b>	<b>15.8%</b>	<b>16.0%</b>	<b>6.5%</b>	<b>21.7%</b>	<b>20.4%</b>	<b>24.9%</b>
<b>Incremental ROIC</b>	<b>67.6%</b>	<b>40.4%</b>	<b>34.6%</b>	<b>N/A</b>	<b>11.2%</b>	<b>60.2%</b>	<b>-23.2%</b>	<b>N/A</b>	<b>N/A</b>	<b>208.5%</b>

**Notes:**

1. Effective tax rate of each year is used.
2. Invested capital is equal to Total Assets – Cash – non-interest-bearing current liabilities + Operating Leases. Operating leases are added to the calculation because they represent tangible assets essential for Starbucks' operations. Prior to 2019, operating leases were not required to be included on the Balance Sheet under US GAAP.
3. Cash includes cash and short-term investments.
4. Non-interest-bearing current liabilities include accounts payable and other current liabilities.
5. Operating income in FY2008 was primarily related to the significant store closures in the U.S. and softness in U.S. revenue along with higher cost during the Financial Crisis. The challenging environment extended into FY2009.<sup>132</sup>
6. 0.4% ROIC in 2013 was due to a one-time litigation charge of \$2.78 billion with Kraft.
7. In 2020, COVID-19 negatively impacted the operating income of the company.

<sup>132</sup> Starbucks Annual Report 2009.

**Figure 23-4: Return on Tangible Capital Employed (1990-2023)**

\$, millions	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
EBIT	\$ 1	\$ 3	\$ 6	\$ 13	\$ 23	\$ 40	\$ 57	\$ 88	\$ 109	\$ 157	\$ 221	\$ 281
Tangible Capital	\$ 26	\$ 47	\$ 76	\$ 154	\$ 322	\$ 583	\$ 759	\$ 1,005	\$ 1,355	\$ 1,647	\$ 2,041	\$ 2,781
NWC	\$ 1	\$ 5	\$ 7	\$ 14	\$ 40	\$ 85	\$ 25	\$ 50	\$ 68	\$ 81	\$ 71	\$ (9)
=CA (ex. Cash)	\$ 4	\$ 11	\$ 15	\$ 32	\$ 69	\$ 143	\$ 110	\$ 163	\$ 214	\$ 269	\$ 328	\$ 373
-CL (ex. STD)	\$ 3	\$ 6	\$ 8	\$ 18	\$ 28	\$ 58	\$ 85	\$ 113	\$ 146	\$ 187	\$ 256	\$ 383
+NFA	\$ 15	\$ 22	\$ 34	\$ 66	\$ 141	\$ 245	\$ 369	\$ 483	\$ 601	\$ 760	\$ 931	\$ 1,136
+Operating Lease	\$ 10	\$ 20	\$ 35	\$ 74	\$ 141	\$ 253	\$ 365	\$ 472	\$ 686	\$ 805	\$ 1,039	\$ 1,655
<b>ROTCE</b>	<b>3.1%</b>	<b>6.2%</b>	<b>8.4%</b>	<b>8.4%</b>	<b>7.2%</b>	<b>6.9%</b>	<b>7.5%</b>	<b>8.8%</b>	<b>8.1%</b>	<b>9.5%</b>	<b>10.8%</b>	<b>10.1%</b>
<b>Incremental ROTCE</b>		<b>10.0%</b>	<b>12.0%</b>	<b>8.5%</b>	<b>6.1%</b>	<b>6.5%</b>	<b>9.5%</b>	<b>12.7%</b>	<b>6.0%</b>	<b>16.3%</b>	<b>16.2%</b>	<b>8.2%</b>
\$, millions	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
EBIT	\$ 319	\$ 425	\$ 610	\$ 781	\$ 894	\$ 1,054	\$ 504	\$ 562	\$ 1,419	\$ 1,729	\$ 1,997	\$ (325)
Tangible Capital	\$ 3,260	\$ 3,610	\$ 4,014	\$ 4,893	\$ 6,022	\$ 7,720	\$ 8,004	\$ 6,715	\$ 6,028	\$ 6,081	\$ 6,672	\$ 4,647
NWC	\$ (17)	\$ (34)	\$ (67)	\$ (47)	\$ (159)	\$ (187)	\$ (50)	\$ (211)	\$ (472)	\$ (332)	\$ (47)	\$ (3,140)
=CA (ex. Cash)	\$ 445	\$ 574	\$ 715	\$ 902	\$ 1,076	\$ 1,258	\$ 1,426	\$ 1,370	\$ 1,307	\$ 1,744	\$ 2,163	\$ 2,238
-CL (ex. STD)	\$ 462	\$ 608	\$ 782	\$ 949	\$ 1,235	\$ 1,445	\$ 1,476	\$ 1,581	\$ 1,779	\$ 2,076	\$ 2,210	\$ 5,377
+NFA	\$ 1,266	\$ 1,385	\$ 1,471	\$ 1,842	\$ 2,288	\$ 2,890	\$ 2,956	\$ 2,536	\$ 2,417	\$ 2,355	\$ 2,659	\$ 3,201
+Operating Lease	\$ 2,011	\$ 2,259	\$ 2,609	\$ 3,097	\$ 3,893	\$ 5,017	\$ 5,098	\$ 4,389	\$ 4,084	\$ 4,058	\$ 4,060	\$ 4,586
<b>ROTCE</b>	<b>9.8%</b>	<b>11.8%</b>	<b>15.2%</b>	<b>16.0%</b>	<b>14.8%</b>	<b>13.7%</b>	<b>6.3%</b>	<b>8.4%</b>	<b>23.5%</b>	<b>28.4%</b>	<b>29.9%</b>	<b>-7.0%</b>
<b>Incremental ROTCE</b>	<b>7.9%</b>	<b>30.3%</b>	<b>46.0%</b>	<b>19.4%</b>	<b>10.0%</b>	<b>9.4%</b>	<b>-193.7%</b>	<b>N/A</b>	<b>N/A</b>	<b>583.2%</b>	<b>45.5%</b>	<b>N/A</b>
\$, millions	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023		
EBIT	\$ 3,081	\$ 3,601	\$ 4,172	\$ 4,135	\$ 3,883	\$ 4,078	\$ 1,562	\$ 4,872	\$ 4,618	\$ 5,871		
Tangible Capital	\$ 7,763	\$ 8,846	\$ 10,169	\$ 11,905	\$ 13,505	\$ 13,391	\$ 13,141	\$ 11,843	\$ 12,430	\$ 12,932		
NWC	\$ (714)	\$ (912)	\$ (1,650)	\$ (1,628)	\$ (1,778)	\$ (3,272)	\$ (1,235)	\$ (2,763)	\$ (2,146)	\$ (2,868)		
=CA (ex. Cash)	\$ 2,325	\$ 2,741	\$ 2,497	\$ 2,593	\$ 3,556	\$ 2,897	\$ 3,174	\$ 3,139	\$ 3,836	\$ 3,350		
-CL (ex. STD)	\$ 3,039	\$ 3,654	\$ 4,147	\$ 4,221	\$ 5,334	\$ 6,169	\$ 4,409	\$ 5,901	\$ 5,982	\$ 6,218		
+NFA	\$ 3,519	\$ 4,088	\$ 4,534	\$ 4,920	\$ 5,929	\$ 6,432	\$ 14,376	\$ 14,606	\$ 14,576	\$ 15,800		
+Operating Lease	\$ 4,958	\$ 5,670	\$ 7,285	\$ 8,614	\$ 9,354	\$ 10,231	\$ -	\$ -	\$ -	\$ -		
<b>ROTCE</b>	<b>39.7%</b>	<b>40.7%</b>	<b>41.0%</b>	<b>34.7%</b>	<b>28.8%</b>	<b>30.5%</b>	<b>11.9%</b>	<b>41.1%</b>	<b>37.2%</b>	<b>45.4%</b>		
<b>Incremental ROTCE</b>	<b>109.3%</b>	<b>48.0%</b>	<b>43.1%</b>	<b>-2.1%</b>	<b>-15.7%</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>-43.3%</b>	<b>249.4%</b>		

Notes:

1. Operating leases in FY1991 and FY1992 was assumed to be the lower than FY1992 because of limited data prior to IPO.
2. Operating leases in FY1995 was assumed to be the average of FY1994 and FY1996 because of limited data.
3. Operating income in FY2008 was primarily related to the significant store closures in the U.S. and softness in U.S revenue along with higher cost during the Financial Crisis. The challenging environment extended into FY2009.<sup>133</sup>
4. Operating income in FY2008 was primarily related to the significant store closures in the U.S. and softness in U.S revenue along with higher cost during the Financial Crisis. The challenging environment extended into FY2009.<sup>134</sup>
5. The negative RoTCE in 2013 was due to a one-time litigation charge of \$2.78 billion with Kraft.
6. In 2020, COVID-19 negatively impacted the operating income of the company.

**Figure 24: Pro-Forma Balance Sheet (1990 – 2023)**

All figures in millions of U.S. Dollar except per share items.	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Cash & Cash Equivalents	4.42	1.12	37.74	34.50	15.92	62.45	229.44	153.63	123.54	117.79	132.15
Accounts Receivable	0.53	0.85	1.57	2.86	5.39	9.85	17.62	30.52	50.97	47.65	76.39
Inventories	3.28	8.12	11.72	24.25	56.06	123.66	83.37	119.53	143.12	180.89	201.66
Other Current Assets	0.62	1.72	2.14	4.63	7.20	9.39	9.11	12.93	19.65	40.18	49.63
<b>Total Current Assets</b>	<b>8.85</b>	<b>11.82</b>	<b>53.17</b>	<b>66.23</b>	<b>84.58</b>	<b>205.35</b>	<b>339.54</b>	<b>316.61</b>	<b>337.28</b>	<b>386.50</b>	<b>459.82</b>
Net Property, Plant & Equipment	14.62	22.34	33.57	65.75	140.75	244.73	369.48	483.26	600.79	760.29	930.76
Operating Lease Right of Use	-	-	-	-	-	-	-	-	-	-	-
Goodwill and Other Intangible Assets	-	-	-	-	-	-	-	-	-	14.19	21.31
Other Long Term Assets	4.41	4.04	1.13	4.07	6.09	6.47	13.19	16.34	15.76	23.47	25.40
<b>Total Assets</b>	<b>27.88</b>	<b>38.19</b>	<b>87.87</b>	<b>136.05</b>	<b>231.42</b>	<b>456.55</b>	<b>722.21</b>	<b>816.21</b>	<b>953.84</b>	<b>1,184.45</b>	<b>1,437.29</b>
ST Debt & Curr. Portion LT Debt	1.36	2.71	4.58	6.22	11.97	13.14	16.24	25.81	33.63	64.21	57.02
Current Portion of Operating Lease	-	-	-	-	-	-	-	-	-	-	-
Accounts Payable	1.82	3.43	4.01	5.65	9.13	28.67	38.03	46.32	54.45	56.11	73.65
Stored Value Card Liability (Deferred Revenue Pre-2014)	-	-	-	-	-	-	-	-	-	-	-
Other Current Liabilities	1.20	2.45	3.99	12.52	19.33	29.24	46.82	66.90	91.40	131.28	182.58
<b>Total Current Liabilities</b>	<b>4.38</b>	<b>8.59</b>	<b>12.58</b>	<b>24.40</b>	<b>40.42</b>	<b>71.05</b>	<b>101.09</b>	<b>139.03</b>	<b>179.48</b>	<b>251.60</b>	<b>313.25</b>
Long-Term Debt	17.24	22.30	-	80.50	80.50	80.40	165.02	165.02	-	7.02	6.48
Operating Lease Liabilities	-	-	-	-	-	1.01	1.73	2.01	-	-	-
Other Long Term Liabilities	-	-	-	-	0.61	3.49	7.11	12.78	18.98	32.89	21.41
<b>Total Liabilities</b>	<b>21.62</b>	<b>30.88</b>	<b>12.58</b>	<b>104.90</b>	<b>121.52</b>	<b>155.95</b>	<b>274.95</b>	<b>318.84</b>	<b>198.46</b>	<b>291.50</b>	<b>341.14</b>
<b>Total Equity</b>	<b>6.26</b>	<b>7.30</b>	<b>75.29</b>	<b>88.07</b>	<b>109.90</b>	<b>312.23</b>	<b>451.66</b>	<b>531.83</b>	<b>794.30</b>	<b>961.01</b>	<b>1,151.99</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>27.88</b>	<b>38.19</b>	<b>87.87</b>	<b>192.97</b>	<b>231.42</b>	<b>468.18</b>	<b>726.61</b>	<b>850.67</b>	<b>992.76</b>	<b>1,252.51</b>	<b>1,493.13</b>
Total Tangible Book Value	6.26	7.30	75.29	88.07	109.90	312.23	451.66	531.83	794.30	946.82	1,130.68

<sup>133</sup> Starbucks Annual Report 2009.

<sup>134</sup> Starbucks Annual Report 2009.

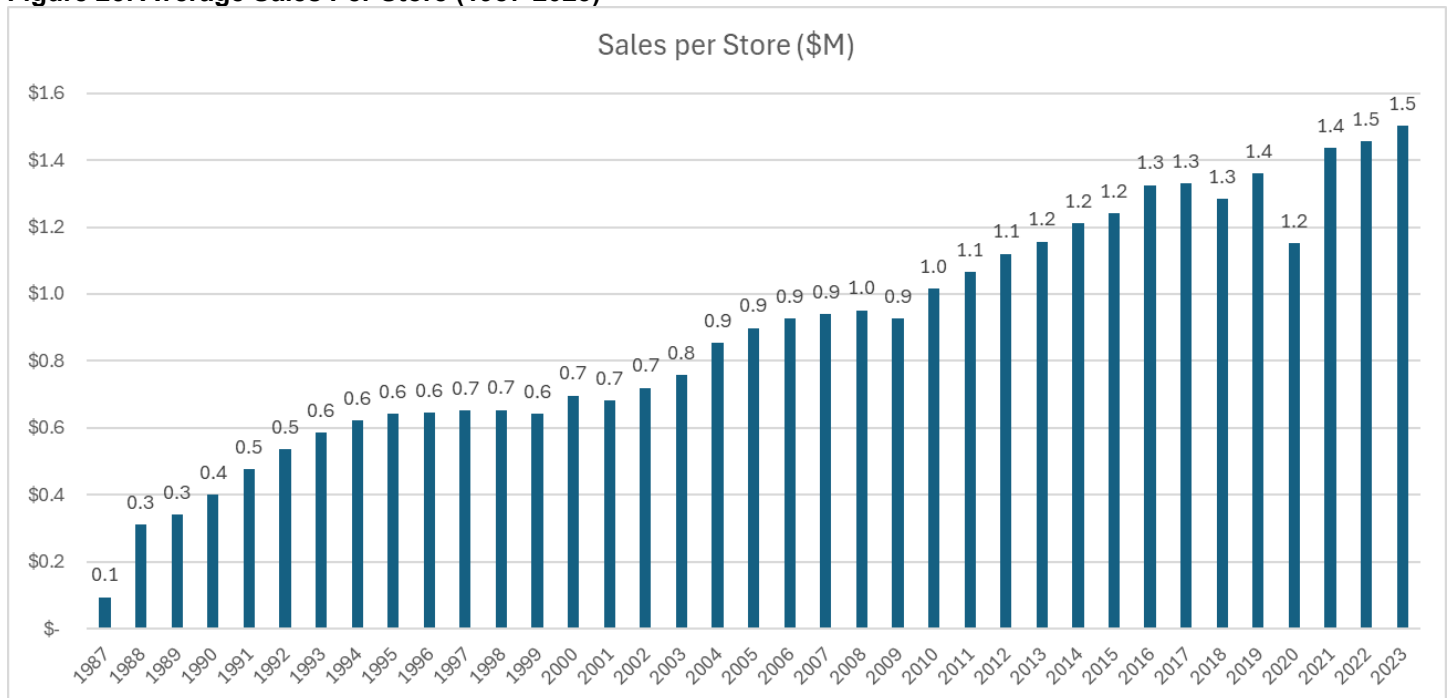
All figures in millions of U.S. Dollar except per share items.	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Cash &amp; Cash Equivalents</b>	220.55	402.23	350.01	653.01	307.04	453.64	438.69	322.30	666.10	1,449.70	2,050.70
<b>Accounts Receivable</b>	90.43	97.57	114.45	140.23	190.76	224.27	287.93	329.50	271.00	302.70	386.50
<b>Inventories</b>	221.25	263.17	342.94	422.66	546.30	636.22	691.66	692.80	664.90	543.30	965.80
<b>Other Current Assets</b>	61.70	84.56	116.63	152.59	165.24	215.65	278.21	403.40	433.80	460.70	391.90
<b>Total Current Assets</b>	<b>593.93</b>	<b>847.54</b>	<b>924.03</b>	<b>1,368.49</b>	<b>1,209.33</b>	<b>1,529.79</b>	<b>1,696.49</b>	<b>1,748.00</b>	<b>2,035.80</b>	<b>2,756.40</b>	<b>3,794.90</b>
<b>Net Property, Plant &amp; Equipment</b>	1,135.78	1,265.76	1,384.90	1,471.45	1,842.02	2,287.90	2,890.43	2,956.40	2,536.40	2,416.50	2,355.00
<b>Operating Lease Right of Use</b>	-	-	-	-	-	-	-	-	-	-	-
<b>Goodwill and Other Intangible Assets</b>	21.85	19.90	88.29	95.75	127.88	199.43	257.67	333.10	327.30	333.20	433.50
<b>Other Long Term Assets</b>	36.39	53.55	52.11	85.56	72.89	186.92	219.42	261.10	253.80	346.50	297.70
<b>Total Assets</b>	<b>1,787.94</b>	<b>2,186.75</b>	<b>2,449.33</b>	<b>3,021.24</b>	<b>3,252.13</b>	<b>4,204.04</b>	<b>5,064.01</b>	<b>5,298.60</b>	<b>5,153.30</b>	<b>5,852.60</b>	<b>6,881.10</b>
<b>ST Debt &amp; Curr. Portion LT Debt</b>	62.68	75.61	0.72	0.74	277.75	700.76	711.02	713.70	0.20	-	-
<b>Current Portion of Operating Lease</b>	-	-	-	-	-	-	-	-	-	-	-
<b>Accounts Payable</b>	127.91	135.99	168.98	199.35	220.98	340.94	390.84	324.90	267.10	282.60	540.00
<b>Stored Value Card Liability (Deferred Revenue Pre-2014)</b>	9.95	42.26	73.48	121.38	175.05	231.93	296.90	368.40	388.70	414.10	449.30
<b>Other Current Liabilities</b>	244.72	283.63	365.52	461.52	553.23	662.00	756.81	782.70	925.00	1,082.40	1,086.50
<b>Total Current Liabilities</b>	<b>445.26</b>	<b>537.49</b>	<b>608.70</b>	<b>782.98</b>	<b>1,227.00</b>	<b>1,935.62</b>	<b>2,155.57</b>	<b>2,189.70</b>	<b>1,581.00</b>	<b>1,779.10</b>	<b>2,075.80</b>
<b>Long-Term Debt</b>	5.79	5.08	4.35	3.62	2.87	1.96	550.12	549.60	549.30	549.40	549.50
<b>Operating Lease Liabilities</b>	-	-	-	-	-	-	-	-	-	-	-
<b>Other Long Term Liabilities</b>	19.13	23.53	34.26	54.82	182.38	252.12	336.82	427.20	389.60	375.10	347.80
<b>Total Liabilities</b>	<b>470.18</b>	<b>566.10</b>	<b>647.32</b>	<b>841.41</b>	<b>1,412.25</b>	<b>2,189.70</b>	<b>3,042.51</b>	<b>3,166.50</b>	<b>2,519.90</b>	<b>2,703.60</b>	<b>2,973.10</b>
<b>Total Equity</b>	<b>1,380.86</b>	<b>1,726.64</b>	<b>2,082.43</b>	<b>2,486.76</b>	<b>2,101.79</b>	<b>2,239.25</b>	<b>2,301.37</b>	<b>2,506.10</b>	<b>3,056.90</b>	<b>3,682.30</b>	<b>4,387.30</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>1,851.04</b>	<b>2,292.74</b>	<b>2,729.75</b>	<b>3,328.17</b>	<b>3,514.04</b>	<b>4,428.94</b>	<b>5,343.88</b>	<b>5,672.60</b>	<b>5,576.80</b>	<b>6,385.90</b>	<b>7,360.40</b>
<b>Total Tangible Book Value</b>	<b>1,359.01</b>	<b>1,706.74</b>	<b>1,994.14</b>	<b>2,391.01</b>	<b>1,973.90</b>	<b>2,039.81</b>	<b>2,043.70</b>	<b>2,173.00</b>	<b>2,729.60</b>	<b>3,349.10</b>	<b>3,953.80</b>

All figures in millions of U.S. Dollar except per share items.	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Cash &amp; Cash Equivalents</b>	2,037.00	3,233.80	1,843.80	1,611.40	2,263.20	2,690.90	8,937.80	2,757.10	4,632.10	6,617.90	3,182.90	3,953.00
<b>Accounts Receivable</b>	485.90	561.40	631.00	719.00	768.80	870.40	693.10	879.20	883.40	940.00	1,175.50	1,184.10
<b>Inventories</b>	1,241.50	1,111.20	1,090.90	1,306.40	1,378.50	1,364.00	1,400.50	1,529.40	1,551.40	1,603.90	2,176.60	1,806.40
<b>Other Current Assets</b>	435.20	565.00	603.00	715.90	350.00	358.10	1,462.80	488.20	739.50	594.60	483.70	359.90
<b>Total Current Assets</b>	<b>4,199.60</b>	<b>5,471.40</b>	<b>4,168.70</b>	<b>4,352.70</b>	<b>4,760.50</b>	<b>5,283.40</b>	<b>12,494.20</b>	<b>5,653.90</b>	<b>7,806.40</b>	<b>9,756.40</b>	<b>7,018.70</b>	<b>7,303.40</b>
<b>Net Property, Plant &amp; Equipment</b>	2,658.90	3,200.50	3,519.00	4,088.30	4,533.80	4,919.50	5,929.10	6,431.70	6,241.40	6,369.50	6,560.50	7,387.10
<b>Operating Lease Right of Use</b>	-	-	-	-	-	-	-	-	8,134.10	8,236.00	8,015.60	8,412.60
<b>Goodwill and Other Intangible Assets</b>	542.80	1,137.70	1,129.70	2,095.80	2,235.90	1,980.60	4,583.80	4,272.60	4,149.30	4,027.20	3,439.40	3,338.80
<b>Other Long Term Assets</b>	242.00	1,152.30	1,102.20	1,244.80	1,303.10	1,158.20	546.90	2,245.40	3,043.30	2,453.30	2,353.90	2,316.30
<b>Total Assets</b>	<b>7,643.30</b>	<b>10,961.90</b>	<b>9,919.60</b>	<b>11,781.60</b>	<b>12,833.30</b>	<b>13,341.70</b>	<b>23,554.00</b>	<b>18,603.60</b>	<b>29,374.50</b>	<b>30,842.40</b>	<b>27,388.10</b>	<b>28,758.20</b>
<b>ST Debt &amp; Curr. Portion LT Debt</b>	-	-	-	-	400.00	-	349.90	-	1,688.70	998.90	1,924.00	1,852.10
<b>Current Portion of Operating Lease</b>	-	-	-	-	-	-	-	-	1,248.80	1,251.30	1,245.70	1,275.30
<b>Accounts Payable</b>	398.10	491.70	533.70	684.20	730.60	782.50	1,179.30	1,189.70	997.90	1,211.60	1,441.40	1,544.30
<b>Stored Value Card Liability (Deferred Revenue Pre-2014)</b>	510.20	653.70	794.50	983.80	1,171.20	1,288.50	1,328.60	1,113.70	1,280.50	1,448.50	1,503.00	1,567.50
<b>Other Current Liabilities</b>	1,301.50	4,231.90	1,710.50	1,985.50	2,245.10	2,149.70	2,826.40	3,865.30	2,130.90	3,241.10	3,037.70	3,106.10
<b>Total Current Liabilities</b>	<b>2,209.80</b>	<b>5,377.30</b>	<b>3,038.70</b>	<b>3,653.50</b>	<b>4,546.90</b>	<b>4,220.70</b>	<b>5,684.20</b>	<b>6,168.70</b>	<b>7,346.80</b>	<b>8,151.40</b>	<b>9,151.80</b>	<b>9,345.30</b>
<b>Long-Term Debt</b>	549.60	1,299.40	2,048.30	2,347.50	3,202.20	3,932.60	9,090.20	11,167.00	14,659.60	13,616.90	13,119.90	13,547.60
<b>Operating Lease Liabilities</b>	-	-	-	-	-	-	-	-	7,661.70	7,738.00	7,515.20	7,924.80
<b>Other Long Term Liabilities</b>	345.30	357.70	392.20	625.30	689.70	755.30	8,206.20	8,114.90	7,505.80	7,200.80	6,890.20	6,615.60
<b>Total Liabilities</b>	<b>3,104.70</b>	<b>7,034.40</b>	<b>5,479.20</b>	<b>6,626.30</b>	<b>8,438.80</b>	<b>8,908.60</b>	<b>22,980.60</b>	<b>25,450.60</b>	<b>37,173.90</b>	<b>36,707.10</b>	<b>36,677.10</b>	<b>37,433.30</b>
<b>Total Equity</b>	<b>5,114.50</b>	<b>4,482.30</b>	<b>5,273.70</b>	<b>5,819.80</b>	<b>5,890.70</b>	<b>5,457.00</b>	<b>1,175.80</b>	<b>(6,231.00)</b>	<b>(7,799.40)</b>	<b>(5,314.45)</b>	<b>(8,698.70)</b>	<b>(7,987.80)</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>8,219.20</b>	<b>11,516.70</b>	<b>10,752.90</b>	<b>12,446.10</b>	<b>14,329.50</b>	<b>14,365.60</b>	<b>24,156.40</b>	<b>19,219.60</b>	<b>29,374.50</b>	<b>31,392.65</b>	<b>27,978.40</b>	<b>29,445.50</b>
<b>Total Tangible Book Value</b>	<b>4,571.70</b>	<b>3,344.60</b>	<b>4,144.00</b>	<b>3,724.00</b>	<b>3,654.80</b>	<b>3,476.40</b>	<b>(3,408.00)</b>	<b>(10,503.60)</b>	<b>(11,948.70)</b>	<b>(9,341.65)</b>	<b>(12,138.10)</b>	<b>(11,326.60)</b>

Notes:

1. The long-term debt of 1990 and 1991 include redeemable of preferred stock of \$13.34 million and \$14.85 million, respectively.
2. Stored Value Card Liability pre-2014 was categorized as Deferred Revenue.

**Figure 25: Average Sales Per Store (1987-2023)**



Note:

1. Average sales per store are estimated as total sales from company-operated stores divided by the total number of company-operated stores extracted from annual reports.

Starbucks' comparable store sales have generally increased each year since 1990, when data tracking began. In most years, this growth in comparable sales is driven by both higher transaction volume and increased average ticket sizes, as shown in Figure 26. The company has managed to boost its average ticket size, including price increases, without significantly impacting traffic volume. However, Starbucks sometimes opens stores in close proximity within densely populated areas, believing that such clustering can drive sales despite potential cannibalization.<sup>135</sup> This can occasionally lead to a drop in comparable store sales in certain locations.

Starbucks sometimes employs a bold strategy of self-cannibalization in certain areas, strategically opening multiple stores in close proximity to one another. While this may seem counterintuitive, it's part of their long-term plan to dominate the market and reinforce their leading position.<sup>136</sup> The company sees this approach as an investment rather than a loss, viewing it as a means to expand their market share. However, the success of this strategy varies depending on factors like location and timing. An illustrative example occurred in 2015 when Starbucks opened a new store just 30 yards away from an existing one in Wall Street.<sup>137</sup> Despite initial expectations of a 10%-15% cannibalization rate, there was surprisingly no cannibalization at all. The bustling nature of Wall Street kept both stores thriving. Yet, this strategy isn't without its risks. During Japan's economic downturn in 2001-2002,<sup>138</sup> Starbucks felt the impact of self-cannibalization. One of their stores in Sapporo, which initially boasted \$6 million in sales, saw a drastic 50% decline in comparable sales due to the opening of two nearby stores. This downturn, combined with the sluggish economy, resulted in a significant revenue drop, with one store captured \$3 million while each of the other two only had \$ 1million.<sup>139</sup> **Despite occasional setbacks, Starbucks has generally seen positive results from its self-cannibalization strategy. From its IPO in 1992 until the onset of the Great Financial Crisis in 2008, the company achieved 16 years of consecutive growth in comparable sales, even as 30% of its stores experienced self-cannibalization.<sup>140</sup>**

<sup>135</sup> Starbucks Prospectus.

<sup>136</sup> Starbucks Q2 2003 Earnings Call.

<sup>137</sup> 5/28/2015, Starbucks Sanford C. Bernstein Strategic Decision Conference.

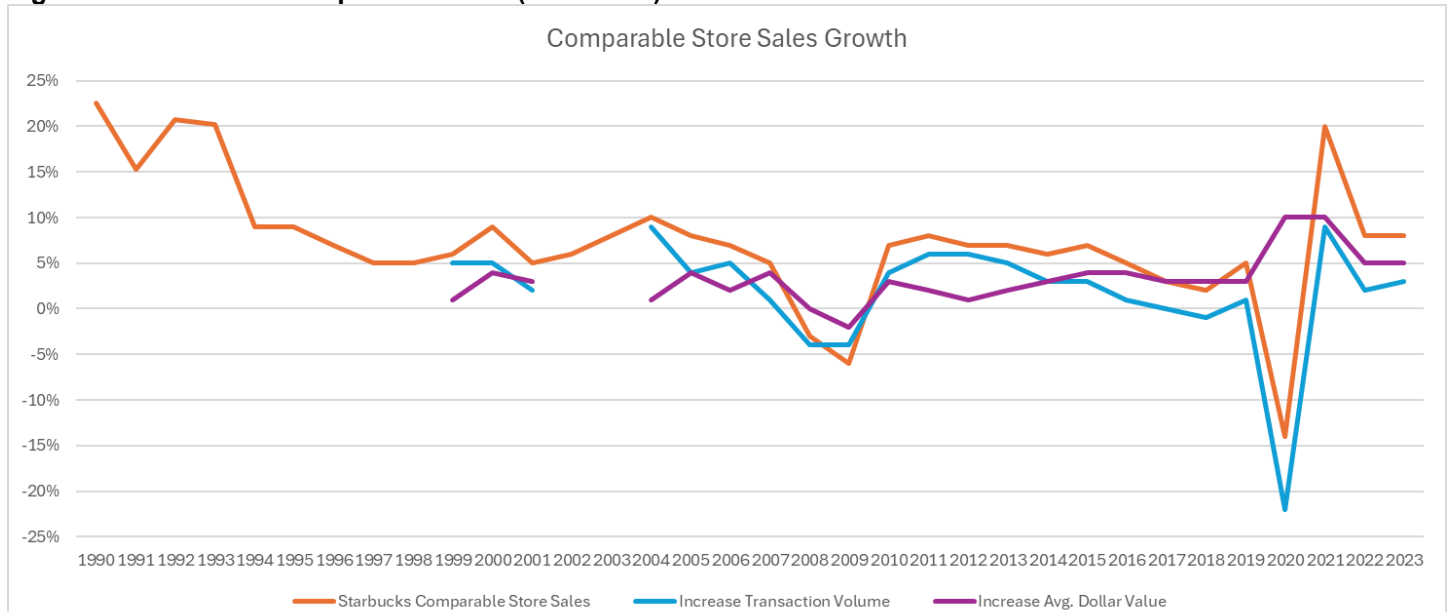
<sup>138</sup> 2/13/2003, Japan's Lost Decade.

<https://www.imf.org/external/pubs/nft/2003/japan/index.htm#:~:text=At%20the%20time%20of%20writing,States%20and%20Asian%20economies%20rebounded.>

<sup>139</sup> Starbucks Q1 2003 Earnings Call.

<sup>140</sup> 9/13/2022, Starbucks Investor Day.

**Figure 26: Starbucks Comparable Sales (1990-2023)**



	<b>1990</b>	<b>1991</b>	<b>1992</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>
<b>Starbucks Comparable Store Sales</b>	23%	15%	21%	20%	9%	9%	7%	5%	5%	6%	9%	5%
<b>Increase Transaction Volume</b>										5%	5%	2%
<b>Increase Avg. Dollar Value</b>										1%	4%	3%
	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
<b>Starbucks Comparable Store Sales</b>	6%	8%	10%	8%	7%	5%	-3%	-6%	7%	8%	7%	7%
<b>Increase Transaction Volume</b>			9%	4%	5%	1%	-4%	-4%	4%	6%	6%	5%
<b>Increase Avg. Dollar Value</b>			1%	4%	2%	4%	0%	-2%	3%	2%	1%	2%
	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>		
<b>Starbucks Comparable Store Sales</b>	6%	7%	5%	3%	2%	5%	-14%	20%	8%	8%		
<b>Increase Transaction Volume</b>	3%	3%	1%	0%	-1%	1%	-22%	9%	2%	3%		
<b>Increase Avg. Dollar Value</b>	3%	4%	4%	3%	3%	3%	10%	10%	5%	5%		

**Notes:**

1. The growth in comparable store sales from 1990 to 1991 is primarily as a result of increased transaction volume.<sup>141</sup>
2. The growth in comparable store sales in 1992 is a result of greater transaction volume and increased average ticket size. The company stated that there was no general price increase during the year.<sup>142</sup>
3. In 1993, comparable sales grew due to increased transaction volume and average ticket size. On 9/13/1993, the company raised coffee beverages price in certain markets, which had no significant effect on the current year sales.<sup>143</sup>
4. In 1994, comparable sales grew as a result of increased transaction volume and average ticket size. The company increased the price on coffee beverages and whole bean coffee in response to counter the increase in cost of supplies. Management believed that the portion of net sales that increased as a result of price increase in September 1993 and July 1994, was not significant. Management anticipated that the 1994 price increase could lead to approximately 5% increase in retail sales during FY1995, but not the total sales.
5. In 1995, comparable sales grew as a result of increased transaction volume and average ticket size. The increase in average dollar value per transaction included an increase in coffee beverage and whole bean prices which took place in July 1994.
6. During 1996-1998, comparable sales grew as a result of increased transaction volume and average ticket size. During FY1997, the company increased prices on its whole bean coffees and its coffee beverages to mitigate the effects of anticipated increases in its costs of supply.
7. In 2000, the company increased its retail beverage price.
8. In 2001, the company increased its retail beverage price despite lower green coffee costs.

<sup>141</sup> Starbucks Prospectus.

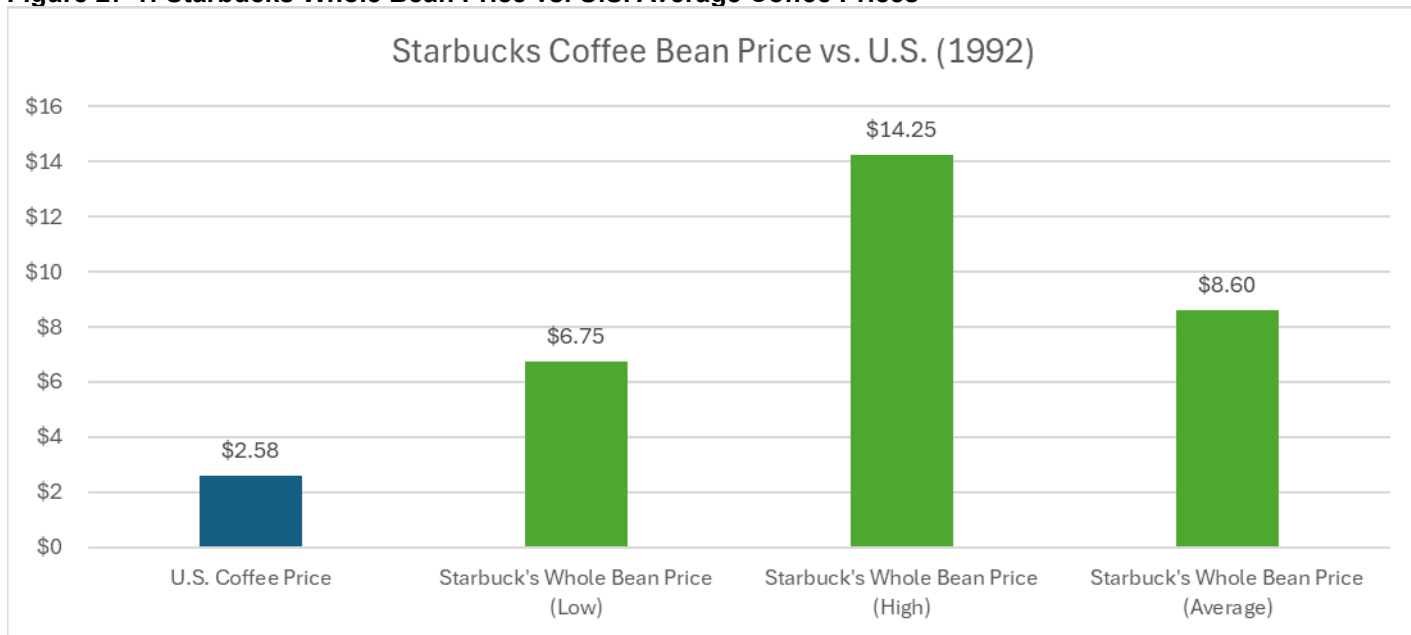
<sup>142</sup> Starbucks Annual Report 1992.

<sup>143</sup> Starbucks Annual Report 1993.

9. In 2002, comparable sales grew due to higher transaction volume from higher traffic volume, driven by new product innovation, which continues to broaden the customer base during non-peak hours of operation, and by expanding the Company's capacity to satisfy customer demand through enhanced technology, training and execution at retail stores.
10. In 2003, comparable sales growth was driven almost entirely by increased transactions.
11. In 2004, comparable sales growth was driven by increased transaction volume, especially in North America. The management team did not think such a high growth would sustain and believed that it was driven by new product innovation, popularity of core products, a high level of customer satisfaction, and improved speed through enhanced technology, training, and execution at retail stores.
12. In 2005, the increase in the average value per transaction was primarily due to a beverage price increase in October 2004 in the Company's U.S. and Canadian markets. 3% of 9% comparable store sales growth in the U.S. was attributable price increase in October 2004.
13. In 2006, the management team believes increased customer traffic continues to be driven by sustained popularity of core products, new product innovation and a high level of customer satisfaction.
14. During 2007-2009, comparable sales show deteriorating trend as a result of slow economic conditions and combined with two price increases in U.S. retail stores.
15. During 2020-2023, price increases due to COVID disruption and the inflation in the U.S..

To analyze Starbucks' pricing power over its customers, especially in the earlier years, we can look at various indicators given limited data. Despite operating in a highly competitive industry, Starbucks has demonstrated some pricing power. It competes not only with other specialty coffee shops but also with grocers and consumer packaged goods companies that sell coffee and other beverages like carbonated drinks and tea. **Starbucks whole-bean coffee has historically been priced significantly higher than the average coffee price in the U.S. As shown in Figure 27-1, in 1992, Starbucks' whole-bean coffee had an average price of \$8.60 per pound, while the market average for coffee in the U.S. was only \$2.58 per pound, indicating a considerable premium. This price disparity suggests that Starbucks' brand strength and customer loyalty allow it to maintain higher prices compared to the broader market while still retaining its customer base. The company's ability to command such a premium in a crowded market underscores its strong brand identity and pricing power.** Figure 27-2 reinforces the notion that Starbucks not only commands higher prices compared to the overall market average but also stands as the undisputed leader in the premium coffee segment. It not only charges prices nearing the upper tier but also outperforms its competitors in terms of volume sold, without any close competitors. This underscores Starbucks' dominance in both pricing strategy and market share within the premium coffee sector.

**Figure 27-1: Starbucks Whole Bean Price vs. U.S. Average Coffee Prices<sup>144</sup>**

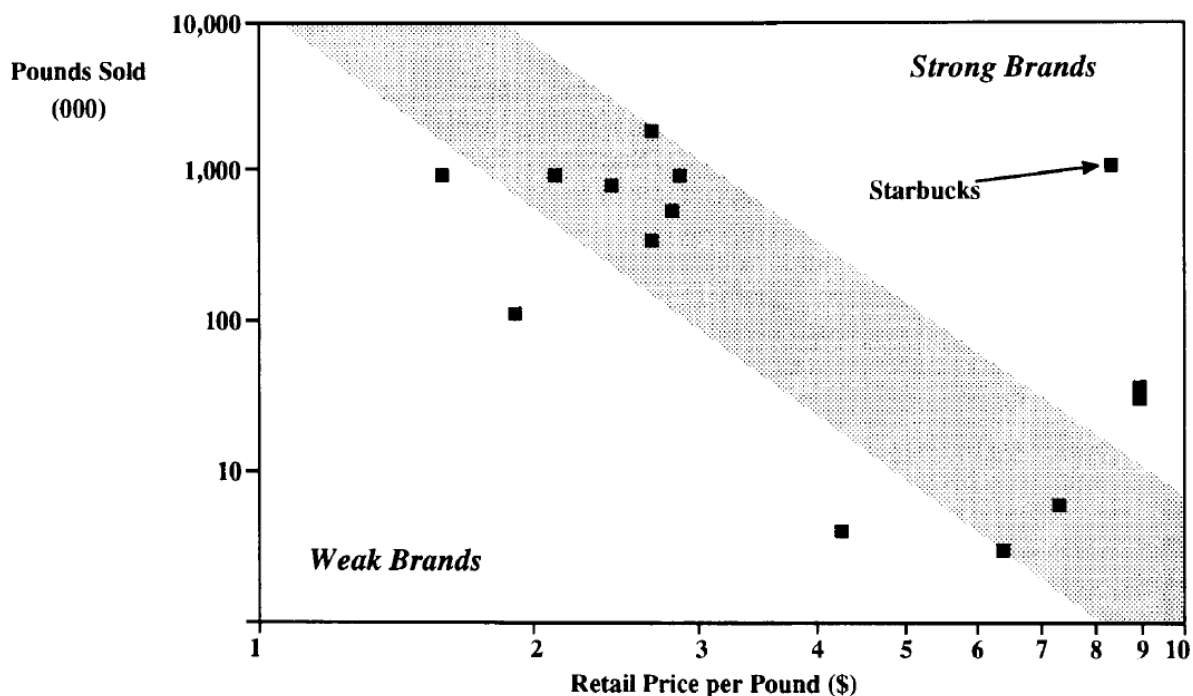


Note:

<sup>144</sup> U.S. Bureau of Labor Statistics: Annual Average for Coffee, 100%, ground roast, all sizes, per lb. (453.6 gm) in U.S. city average, average price, not seasonally adjusted. CPI Average Price Data. <https://www.usinflationcalculator.com/inflation/coffee-prices-by-year-and-adjust-for-inflation/>

1. Because of limited data, the U.S. average U.S. coffee price is the ground roast.

**Figure 27-2: Brand Strength Map: Coffee in 1992 Seattle Market**  
**Brand Strength Map©: Coffee**  
**1992 Seattle market**



Source: Infoscan, H&Q estimates  
© Hambrecht & Quist, Inc. 1993 Brand Strength Map© is an H&Q trademark identifying a family of brand valuation charts.

Starbucks has increased its coffee beverage prices several times to counter the rising costs of green coffee beans, particularly during periods of high inflation, such as the 1990s and from 2020 to 2023. For example, in 1994, the price of C contract (arabica green beans) spiked from around \$0.80 to \$2.74 per pound within a few months. Although Starbucks had sufficient inventory to maintain its prices for a time, the company ultimately needed to raise its prices to offset these costs. However, the company raised prices by less than \$0.10 per cup because the company thought the prices would have gone up far more dramatically if it had, and explained the reasons to customers, emphasizing the company's commitment to transparency and maintaining good customer relationships.<sup>145</sup>

**Howard Schultz, in his memoir, noted that Starbucks could have used a different strategy—blending high-grade coffee with cheaper beans and raising prices anyway, which is a tactic some competitors seemed to use. He acknowledged that most customers might not notice the difference in quality, given that Starbucks spends more money per pound of coffee than almost any other company, even though probably fewer than 10 percent of its customers can detect subtle differences in taste.**<sup>146</sup> This suggests that, while Starbucks prides itself on offering high-quality coffee, to many customers, coffee is essentially a commodity, limiting Starbucks' pricing power.

To address rising costs and maintain profitability, Starbucks focused on refining its operations to improve efficiency, alongside slight price adjustments. The company adopted computer-integrated manufacturing systems to increase efficiency and reduce costs by 8% to 10% per year.<sup>147</sup> Starbucks also renegotiated contracts to lower transportation and paper cup costs significantly. Because the company was in a growth stage and well-funded, it had the flexibility to make these adjustments without compromising quality. Howard Schultz remarked that the coffee price crisis made Starbucks a better company by highlighting vulnerabilities and driving operational improvements.<sup>148</sup>

<sup>145</sup> Chapter 17, Pour Your Heart Into It.

<sup>146</sup> Chapter 17, Pour Your Heart Into It.

<sup>147</sup> Chapter 17, Pour Your Heart Into It.

<sup>148</sup> Chapter 17, Pour Your Heart Into It.

On the other hand, Peet's Coffee does not disclose its comparable store sales publicly, making it challenging to compare their performance directly with Starbucks regarding same-store traffic volume and average ticket size. While these metrics could offer deeper insights into customer behavior and market trends, the lack of disclosure from some competitors limits direct comparisons.

Starbucks encountered its first consecutive decline in comparable store sales during 2008 and 2009, experiencing drops of 3% and 6% respectively, largely stemming from declined transaction volumes, each at -4%, as Figure 26 shows. The downturn in revenue during 2009 was attributed to both decreased transaction volumes and average ticket sizes. Despite the economic slowdown linked to the Great Financial Crisis, Howard Schultz, who retired as CEO in 2008 and remained as the company's chairman, had noted a shift in Starbucks' core values even before fiscal year 2008. He sensed that "something intrinsic to Starbucks brand was missing."<sup>149</sup>

As Starbucks continued its expansion, becoming increasingly ubiquitous, it faced the challenge of maintaining efficiency and infrastructure. The installation of large espresso machines and the expansion of product offerings aimed to cater to diverse customer preferences. However, large espresso machines obscured the coffee-making process and diminished interactions between baristas and customers. Additionally, in some stores, the aroma of burnt cheese from breakfast sandwiches overpowered the Starbucks coffee scent, detracting from the authentic Starbucks experience.

In his memo to Starbucks team in 2007:

"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 led 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... 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."<sup>150</sup>

Jerry Baldwin pointed out that as a business grows larger, like Starbucks, a greater portion of its market will come from the middle segment, which might lead to a loss of the initial focus on quality aimed at top of the market.<sup>151</sup> Additionally, decision-making could potentially be driven by individuals focused on financials rather than those passionate about coffee.

Howard Schultz acknowledged the necessity of these compromises during a period of rapid expansion. However, he emphasized the urgency of returning to Starbucks' core values and reviving the passion for the true Starbucks experience.

Upon returning as CEO in January 2008, Schultz initiated a transformation plan, ensuring that integral company practices, including healthcare benefits and Bean Stock, remained unchanged. The plan aimed to enhance the retail business in the U.S., improve emotional attachment to the Starbucks brand, and make long-term changes to the business foundation. This involved slowing down store openings, closing underperforming locations, developing new products, and enhancing customer experiences.

Following a period of aggressive expansion from 2000 to 2007, Starbucks significantly curtailed its speed of opening new stores. From 2000 to 2007, Starbucks opened over 1,000 stores net worldwide, both company-operated and licensed stores. It net opened 2,199 stores in 2006 and 2,571 stores in 2007, reaching 12,440 and 15,011 stores, respectively. The company slowed down significantly in opening new stores. In FY2008, it net-opened only 1,669 stores globally to 16,680 stores in total. In FY2009, it net-closed 45 stores globally and had 16,635 stores globally and remained below 17,000 until FY2012 before it started to expand again.<sup>152</sup> In addition, the replacement of automatic espresso machines with the newly designed Mastrena machines aimed to offer greater customization without obstructing customer interactions, evoking the vibe of old-time Starbucks.

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<sup>149</sup> Starbucks Coffee Company: Transformation and Renewal. HBS Case Study.

<sup>150</sup> The Commoditization of the Starbucks Experience. 2/17/2024. Howard Schultz.

[https://starbucks\\_gossip.typepad.com/ /2007/02/starbucks\\_chair\\_2.html](https://starbucks_gossip.typepad.com/ /2007/02/starbucks_chair_2.html).

<sup>151</sup> Discussion with Jerry Baldwin.

<sup>152</sup> Starbucks Annual Report 2000-2012.

To counter heightened competition, Starbucks introduced new products such as Pike Place Roast, which is “bold and authentic, more approachable, and also worthy of Starbucks heritage.”<sup>153</sup> and Starbucks VIA Ready Brew, which is an instant coffee that Starbucks patented and is comparable with Starbucks fresh brewed. These initiatives, combined with the global recovery from the financial crisis, led to a positive comparable sales growth of 7% by 2010, driven by increases in both transaction volume and average ticket size.

### **Management and Incentives:**

Starbucks Corporation was led by Howard Schultz as CEO from 1985, with a team of managers supporting him through its growth.

Starbucks' management compensation included cash and options. **According to the Starbucks prospectus filed on June 26, 1992, Starbucks' directors and officers combined owned approximately 18.1% of the company's outstanding shares before the IPO, with an estimated 15.8% after the offering. Howard Schultz himself owned 1.11 million shares, or 9.7% of the total shares before the IPO, dropping to 8.7% after the offering. At the IPO price of \$17.0 (unadjusted), Schultz's holdings were worth nearly \$19 million.**<sup>154</sup>

The Starbucks executive team collectively held 1.1 million shares in options under the Key Employee Option Plan, representing about 10% of the outstanding shares, with a value of nearly \$19 million at the IPO price of \$17. Howard Schultz personally held 469,082 shares from options,<sup>155</sup> valued at about \$8 million at IPO price.

In FY1991, the collective salary of all executive officers, comprising 7 individuals, amounted to \$815,866, alongside a bonus sum of \$281,500. Among them, Howard Schultz, serving as the chairman of the board and the company's CEO, received a salary of \$165,058 along with a bonus of \$80,000.<sup>156</sup>

Starbucks went public much earlier than its closest competitors, Peet's and Diedrich, making direct comparisons of management compensation challenging. Even if they were public simultaneously, the significant difference in scale would render compensation comparisons impractical. For instance, in 2000, when Peet's went public, Starbucks and Diedrich had already been public for some time. Starbucks' sales in 2000 were nearly 30 times higher than Diedrich's and 25 times more than Peet's. During that year, Howard Schultz, serving as Starbucks' chief global strategist and chairman, had a salary of \$750,000 and bonuses exceeding \$1.3 million, with additional compensation from options and other benefits.<sup>157</sup> In contrast, Diedrich's chairman had a salary of \$225,000 with no bonus,<sup>158</sup> while Peet's CEO earned nearly \$26,000 without a bonus.<sup>159</sup> These disparities illustrate the difference in scale and financial resources between Starbucks and its competitors, indirectly highlighting the unique position Starbucks held in the specialty coffee industry.

Starbucks' emphasis on employee compensation and benefits has been instrumental in its success as an employer and has significantly contributed to building its brand and fostering customer loyalty. By prioritizing the well-being of its employees, Starbucks cultivates a culture of trust and dedication, leading to improved customer service and reinforcing the company's overall strength. This people-centric approach helps Starbucks attract and retain talented individuals, creating a positive cycle where happy employees lead to satisfied customers and a thriving business.

Starbucks has earned a reputation as one of the best employers across continents. For instance, in 2007, Starbucks was ranked 16<sup>th</sup> on Forbes' "Top 100 Best Companies to Work For."<sup>160</sup> More recently, in 2023, the company was recognized as the No. 1 employer in the Restaurant & Leisure category and No. 46 overall by the JUST Capital rankings.<sup>161</sup> Additionally,

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<sup>153</sup> Howard Schultz, Onward.

<sup>154</sup> Starbucks Prospectus.

<sup>155</sup> Starbucks Prospectus.

<sup>156</sup> Starbucks Prospectus.

<sup>157</sup> Starbucks Proxy Statement 1/22/2002.

<sup>158</sup> Diedrich Proxy Statement 10/26/2000.

<sup>159</sup> Peet's Prospectus.

<sup>160</sup> Starbucks ranks high on Fortune's '100 Best Companies to Work For'. <https://mndaily.com/208079/not-using/world/starbucks-ranks-high-fortunes-100-best-companies-work/>

<sup>161</sup> Starbucks recognized by JUST 100 for industry leading partner benefits and workplace policies. <https://one.starbucks.com/get-the-facts/starbucks-ranked-one-of-americas-most-just-companies/#:~:text=Starbucks%20recognized%20by%20JUST%20100%20for%20industry%20leading%20partner%20benefits%20and>

Fortune named Starbucks No. 1 in the Food Service industry and 14th overall in its "World's Most Admired Companies" rankings for 2023.<sup>162</sup> These rankings involve input from executives, managers, analysts, and employees, reflecting the company's strong workplace culture and practices.

Highlighting its esteemed status as an employer, Starbucks introduced the Starbucks College Achievement Plan, open to all eligible employees, whether full-time or part-time, regardless of their roles.<sup>163</sup> This initiative offers full tuition coverage for a first-time bachelor's degree through Arizona State University's online program, boasting a diverse array of over 140 undergraduate programs. Additionally, Starbucks provides further assistance through the Pathway to Admission program, extending support to eligible employees who may initially fall short of admission requirements.

By 2023, the SCAP had facilitated the graduation of over 12,000 employees, with nearly 90% of Starbucks stores in the U.S. having at least one program participant.<sup>164</sup> One graduate shared, *"It took me a while to actually get back to school but what made me stay with the company regardless was the warmth of the people...From the partners to the customers, everyone was so friendly and supportive and it was nothing like I had experienced...My future goals are to use my degree gained through the SCAP program to impact communities both here and abroad...I am an immigrant and through my scholar work I am serving my community by supporting newly arrived refugees in the area. I am looking forward to telling these truly inspiring and wonderful impact stories back in my store, my community and wherever I go."*<sup>165</sup>

Howard Schultz understood early on that in retail and restaurant businesses, customer service is crucial, and employees are the key touchpoints for customers. He also recognized that these industries often offer some of the lowest pay and worst benefits. Schultz envisioned that by paying employees generously and offering them benefits not found elsewhere, Starbucks could attract well-educated individuals passionate about coffee and eager to provide excellent customer service. The generous benefits package, unique in the industry, sent a clear message:

**"Treat people like family, and they will be loyal and give their all. Stand by people, and they will stand by you."**<sup>166</sup>

Starting in 1988, Starbucks became the first major retailer to offer full health benefits to eligible full- and part-time employees.<sup>167</sup> Part-time employees only needed to work about 20 hours a week to qualify for full benefits, with Starbucks subsidizing 75% of the coverage, while employees paid just 25%.<sup>168</sup> This comprehensive health coverage also extended to employees with terminal illnesses until they became eligible for government programs.<sup>169</sup> **One notable example is a Starbucks employee who passed away from AIDS in 1991. During his final days, the Starbucks benefits plan provided much-needed support to his grieving family.** The family later wrote a letter to Starbucks expressing their gratitude for the company's support, acknowledging that without it, they wouldn't have had the means to care for their loved one.

To take employee satisfaction to the next level, Starbucks introduced "Bean Stock" in 1991, an Employee Stock Ownership Plan that Howard Schultz believed truly set Starbucks apart from other companies.<sup>170</sup> This program granted stock options to all employees, from top managers to baristas, in proportion to their base pay, including part-time employees working at least 20 hours a week. The initiative transformed Starbucks employees from being just "employees"

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<sup>162</sup> The World's Most Admired For More Than Two Decades. <https://one.starbucks.com/get-the-facts/starbucks-named-worlds-most-admired/>

<sup>163</sup> Education Program At Starbucks. <https://stories.starbucks.com/stories/2023/bridge-to-the-future-more-than-12000-have-graduated-through-starbucks-college-achievement-plan/>

<sup>164</sup> Bridge to A Better future: More Than 12,000 Have Graduated through Starbucks College Achievement Plan. <https://stories.starbucks.com/stories/2023/bridge-to-the-future-more-than-12000-have-graduated-through-starbucks-college-achievement-plan/>

<sup>165</sup> Bridge to A Better future: More Than 12,000 Have Graduated through Starbucks College Achievement Plan. <https://stories.starbucks.com/stories/2023/bridge-to-the-future-more-than-12000-have-graduated-through-starbucks-college-achievement-plan/>

<sup>166</sup> Chapter 9, Pour Your Heart Into It.

<sup>167</sup> Partner Benefits. <https://archive.starbucks.com/record/partner-benefits>

<sup>168</sup> Chapter 9, Pour Your Heart Into It.

<sup>169</sup> Chapter 9, Pour Your Heart Into It.

<sup>170</sup> Chapter 9, Pour Your Heart Into It.

to being "partners". This plan enabled employees to become stakeholders in the company, granting them ownership of a share of the business. As they continue to work and contribute to the growth of the company, they have the potential to increase their stake, fostering a sense of collective ownership and collaboration in building the business together. The first grant under this program began on October 1, 1991.

Even Jerry Baldwin, a founder of Starbucks and later owner of Peet's, acknowledged that Starbucks was a leader in stock compensation. Although Starbucks went public much earlier, Peet's stock compensation never went below the management group, except for roasters.<sup>171</sup> Since Alfred Peet founded the company in 1979, Peet's has offered full benefits to employees who work at least 21 hours per week<sup>172</sup> and was one of the early adopters in providing employees with sick leave and vacation time.<sup>173</sup>

This approach to employee benefits and ownership has played a crucial role in fostering a sense of loyalty and commitment among Starbucks staff. It has not only helped Starbucks retain talent but also encouraged a culture where employees feel personally invested in the company's success.

*"Each partner (employee) was awarded stock options worth 12% of his or her annual base pay. A partner earning \$20,000, for example, would be given \$2,400 worth of stock options. He or she could cash in one-fifth of the amount each year after that, simultaneously buying at the first year's low price and selling at the current price, keeping the difference...an employee making \$20,000 a year in 1991 would have been able to cash in his 1991 options alone for more than \$50,000 five year later."<sup>174</sup>*

By the time an employee's stock options are fully vested, they could potentially earn much more than their salary as Starbucks' stock price grows along with the company's development.

Investing in its employees yields two key benefits for Starbucks. **First, the company's employee turnover rate is significantly lower—around 60% to 65%—compared to other retailers and fast-food chains, where turnover can range from 150% to 400%.**<sup>175</sup> For managers, Starbucks' turnover rate is even lower, about 25%, whereas in other retail environments, it's typically above 50%. Given that it costs around \$1,500 per year to provide a Starbucks employee with full benefits, while it costs about \$3,000 to train a new hire, the company saves money by keeping its turnover rate low.

Additionally, because Starbucks' coffeehouses serve many regular customers, high employee turnover can undermine customer loyalty by disrupting the connections that regulars form with familiar staff. Starbucks' lower turnover rate helps maintain these customer-employee relationships, which contributes to overall customer satisfaction and brand loyalty. Keeping experienced employees on board not only reduces training costs but also preserves strong connections between staff and customers, which is vital for a business built on customer service and community.

## Feedback Loops:

### A. Customer Feedback:

At Starbucks, people are the top priority, referring to both employees and customers, creating a positive feedback loop that connects people and products, as depicted in Figure 28. This interconnected approach fosters a harmonious relationship, where employee satisfaction enhances customer experiences, leading to stronger loyalty and ultimately reinforcing Starbucks' commitment to quality and community.

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<sup>171</sup> Discussion with Jerry Baldwin.

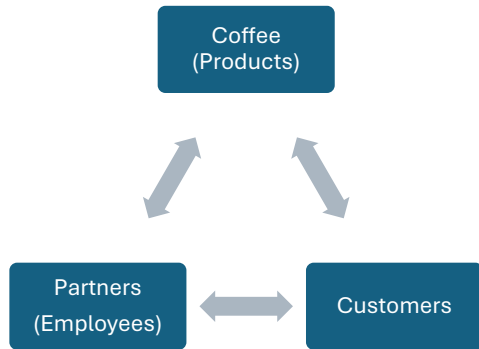
<sup>172</sup> Peet's Annual Report 2000.

<sup>173</sup> Discussion with Jerry Baldwin.

<sup>174</sup> Chapter 9, Pour Your Heart Into It.

<sup>175</sup> Chapter 9, Pour Your Heart Into It.

Figure 28: Starbucks Positive Loop Illustration<sup>176</sup>



Note:

1. Graphed by author for illustration purposes.

Starbucks employs several feedback loops that strengthen its interaction with customers, leading to potential product development or service enhancements, which in turn can drive sales and customer loyalty.

One significant feedback loop is Starbucks' reward program, where customers earn "stars" (points) for purchases, which can be redeemed once a certain threshold is reached. They also receive a free coffee on their birthdays. Customers earn one star for every dollar spent or two stars for every two dollars spent with a pre-loaded Starbucks Card, whether paying in-store or via the Starbucks app. As customers accumulate stars, they unlock various rewards. **For instance, 25 stars allow customers to customize their drinks for free, and 100 stars can be redeemed for a brewed hot or iced coffee.**<sup>177</sup> **If customers don't make purchases at Starbucks for a while, their stars start to expire, encouraging them to visit more frequently. Stars will expire in 6 months after they are earned, while the oldest accrued stars will be used first for redemption.**<sup>178</sup> This gamified approach keeps customers engaged and coming back.

A key advantage of the reward program is the data it provides, enabling Starbucks to make informed decisions. Former CTO Gerri Martin-Flickinger explained in 2016 that *"with our 90 million transactions a week we know a lot about what people are buying, where they're buying, how they're buying, and if we combine this information with other data, like weather, promotions, inventory, insights into local events, we can actually deliver better-personalized service to other customers."*<sup>179</sup> For example, when expanding its product lines in the grocery store, Starbucks derived from the data that 25% of customers do not add milk to their coffee ordered in-store. Therefore, the company launched a new line of black coffee without milk.<sup>180</sup>

This data-driven strategy allows Starbucks to test new ideas, implement targeted promotions, launch new products, reduce menu items, or adjust flavors to suit specific regions and customer segments. By leveraging such detailed information, Starbucks enhances customer experiences and stays competitive in a dynamic market.

Starbucks has a strong customer-centric ethos, with one of its mission statements being to "develop enthusiastically satisfied customers all of the time."<sup>181</sup> The company strives to meet customer expectations in reasonable ways, and some of its current products originate from customer requests. In its earlier years, Starbucks used customer comment cards for feedback on their in-store experiences. Managers, including Howard Schultz, would read these cards and take action accordingly. For instance, even though Schultz, as the founder of Starbucks, believed that espresso-based coffee drinks should be made with whole milk for authenticity, many customers started requesting skim milk due to growing awareness of low-fat diets. Schultz personally observed that some customers were turning to competitors for lattes made with skim milk. Realizing that it is not up to Starbucks to dictate which coffee tastes best, but rather to give customers choices, the

<sup>176</sup> Chapter 9, Pour Your Heart Into It.

<sup>177</sup> Starbucks Rewards. [https://www.starbucks.com/rewards?gad\\_source=1](https://www.starbucks.com/rewards?gad_source=1)

<sup>178</sup> Starbucks Rewards Terms of Use. <https://www.starbucks.com/rewards/terms/>

<sup>179</sup> How Starbucks Uses Data and Insights to Win Big. <https://techhq.com/2018/09/how-starbucks-uses-data-and-insights-to-win-big/#:~:text=%E2%80%9CWith%20our%2090%20million%20transactions,personalized%20service%20to%20other%20customers%20%E2%80%9D>

<sup>180</sup> The Perfect Blend: Starbucks and Data Analytics. <https://d3.harvard.edu/platform-digit/submission/the-perfect-blend-starbucks-and-data-analytics/>

<sup>181</sup> Chapter 9, Pour Your Heart Into It.

company decided to offer skim milk. Schultz later noted that "a lost customer is the most powerful argument you can make to a retailer."<sup>182</sup>

After this change, almost half of the lattes and cappuccinos sold were made with nonfat milk. However, Starbucks doesn't blindly cater to every customer request, choosing instead to protect the core integrity of its products, which is coffee. This balance between accommodating customer feedback and maintaining the essence of the brand has contributed to Starbucks' lasting success. While it responds to customer demands, the company also ensures that it does not compromise on quality or its foundational values. This approach helps Starbucks retain its unique identity while staying responsive to evolving customer preferences.

**A noteworthy example of Starbucks' responsiveness to customer feedback is the creation of the famous Frappuccino. Customers began asking if Starbucks offered an icy blended coffee drink, similar to what some competitors had on their menus. At the time, Starbucks did not have such a product, leading some customers to go elsewhere to satisfy their craving for a blended coffee beverage. In response, Starbucks' store employees began experimenting with their own versions of an icy blended coffee drink. The initial experiments at the store level showed promise, prompting the company to officially roll out Frappuccino nationwide. It took less than five months to retrofit more than 550 stores with blenders and to train baristas on how to make the new drinks. In 1996, the first full year of Frappuccino's nationwide launch, Starbucks sold \$52 million worth of Frappuccino, representing about 7% of the company's total revenue for that year.<sup>183</sup>**

As Starbucks has grown into a large multinational coffee chain, the way it collects customer feedback has evolved. The company now gathers much of its feedback digitally through its mobile app, with surveys like "My Starbucks Experience" in the U.K.,<sup>184</sup> or live chat with a Starbucks agent in the U.S..<sup>185</sup>

These examples demonstrate the dynamic interactions between Starbucks' customers, employees, and the company, showing how customer feedback can lead to innovative product development and successful execution. By listening to its customers and adapting quickly, Starbucks not only creates popular products but also strengthens customer loyalty and reinforces its commitment to customer satisfaction.

## **B. Employee Feedback:**

Starbucks embraces an open and courageous culture, seeing its relationship with employees as a partnership rather than a traditional employer-employee relationship. This philosophy is rooted in the Starbucks Mission Statement, which was established in the early 1990s and emphasizes putting people first and profits second.<sup>186</sup> The goal was to create a set of guiding principles to help evaluate the company's decisions. Each "partner," or employee, could use these principles to assess whether the company's actions align with its mission. To ensure these objectives are met, Starbucks created a Mission Review team. Employees in each store are encouraged to provide feedback to the team via postcard-sized comment cards, reporting any decisions they believe do not adhere to the Mission Statement. Employees can also use this channel to make suggestions for improvement. The company ensures that relevant managers respond to these submissions by letter or phone within two weeks.

Another communication avenue is the quarterly Open Forum, which has been in place since the early 1990s. This forum allows employees from various parts of the company to meet with the management team to discuss their top concerns, seek solutions, and learn about the company's vision and plans.<sup>187</sup> As Starbucks has expanded globally, the Open Forum now takes place in multiple locations, such as the U.S. and China,<sup>188</sup> with both on-site and online participation from employees around the world.<sup>189</sup>

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<sup>182</sup> Chapter 12, Pour Your Heart Into It.

<sup>183</sup> Chapter 15, Pour Your Heart Into It.

<sup>184</sup> My Starbucks Experience. <https://www.starbucks.co.uk/survey-terms>.

<sup>185</sup> Starbucks Customer Service. <https://customerservice.starbucks.com/sbux>

<sup>186</sup> Chapter 9, Pour Your Heart Into It.

<sup>187</sup> Chapter 9. Pour Your Heart Into It.

<sup>188</sup> Starbucks CEO Laxman Narasimhan visits partners in China. <https://stories.starbucks.com/stories/2023/starbucks-ceo-laxman-narasimhan-visits-partners-in-china/>

<sup>189</sup> 'Our best days are in front of us': Howard Schultz shares vision for Starbucks future.

<https://stories.starbucks.com/stories/2022/our-best-days-are-in-front-of-us-howard-schultz-shares-vision-for-starbucks-future/>

These communication channels reflect Starbucks' commitment to fostering a culture of openness and partnership, where employees' voices are heard and valued. By maintaining these practices, the company aims to keep its workforce engaged and aligned with its mission, promoting a sense of community and shared purpose.

**Starbucks fosters an entrepreneurial spirit among its employees, encouraging them to respond to customer demand and take initiative in their work. Many of the company's products have originated from these entrepreneurial efforts. A notable example is the creation of the Frappuccino.** In 1993, store employees began receiving customer inquiries about blended coffee drinks, which were popular at other coffee shops. Starbucks had no immediate plans to explore this product category, but a few store employees, understanding their local market dynamics, began experimenting with blended coffee drinks on their own.<sup>190</sup> Their experimentation caught the attention of the company, leading to official approval to test the new product in individual stores. The trial proved successful, and the Frappuccino eventually became one of Starbucks' signature offerings. This story illustrates how employees' entrepreneurial actions can lead to significant outcomes, benefiting the company as a whole.

**Starbucks also employs third-party consulting firms to regularly survey employees and audit the corporate culture. A 1996 survey revealed high levels of employee satisfaction: 88% of employees were satisfied with their jobs, 85% believed Starbucks showed concern for its employees, 89% were proud to work at Starbucks, and 100% thought "working for a company that you respect" was an important factor in job satisfaction,<sup>191</sup> while another survey showed that only 59% of workers in the U.S. were happy with their jobs.<sup>192</sup>** Despite these high scores, there have been slight declines as Starbucks has grown, with some employees worrying about the company becoming more impersonal. As Starbucks continues to expand, it becomes more challenging for the management team to remember every employee's name, which can impact the close-knit culture Starbucks has cultivated. To maintain its unique culture, Starbucks emphasizes promoting from within and providing a work environment that values emotional rewards and employee well-being.<sup>193</sup>

These efforts reflect Starbucks' commitment to fostering a supportive and respectful workplace, which has contributed to its lower turnover rate and enduring employee loyalty. By continually addressing the needs and concerns of its growing workforce, Starbucks aims to keep its workplace culture vibrant and inclusive, despite the challenges posed by scaling up.

### **C. Management Store Visit**

Store visits take on various forms at Starbucks. In the company's early days, when it was smaller, the management team would often serve customers in-store or simply observe how the business was operating. This hands-on approach allowed them to stay closely connected with day-to-day operations and customer experiences.

As Starbucks expanded to thousands of stores, visiting each location became increasingly challenging. To maintain a connection with the broader network, the management team began hosting Open Forums or visiting individual stores from time to time in various parts of the world, such as a 2023 visit to stores in China or attending the opening of a new store in Japan in 1996. These events allow senior leadership to engage with employees and customers, gaining insights into local market dynamics and employee feedback.

In addition, Starbucks occasionally employs "mystery shoppers" who visit stores posing as regular customers. These mystery shoppers evaluate each location based on a set of criteria, providing valuable feedback on customer service, product quality, cleanliness, and overall experience. This practice helps Starbucks ensure that its high standards are being maintained across all its locations,<sup>194</sup> even as the company continues to grow.

Martin Diedrich recalled an incident from 1989 when he saw Howard Schultz peering through the window of Diedrich Coffee's yet-to-open third store in Orange County ahead of Starbucks' own launch in California.<sup>195</sup> Schultz was closely involved in site selection and store development, especially in the early years of Starbucks' growth. From 1987 to 1991, Schultz personally approved every new site, amounting to more than 100 stores. This highly-engaged approach to site selection prevented costly mistakes tied to poor visibility and traffic – one mistake in site selection could cost them a

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<sup>190</sup> Chapter 9, Pour Your Heart Into It.

<sup>191</sup> Chapter 20, Pour Your Heart Into It.

<sup>192</sup> Workers Rate Jobs As Less Fulfilling A Survey Shows Lower Job Satisfaction Than In 1995, Although There's A Slight Uptick Since A 2003 Study. [https://greensboro.com/article\\_4fb98e46-66c2-5a38-8d23-6e2e3766a542.html](https://greensboro.com/article_4fb98e46-66c2-5a38-8d23-6e2e3766a542.html)

<sup>193</sup> Chapter 20, Pour Your Heart Into It.

<sup>194</sup> Chapter 18, Pour Your Heart Into It.

<sup>195</sup> Discussion with Martin Diedrich.

\$350,000 write-down for leasehold improvements, in addition to the cost of getting out of the lease, not to mention the opportunity cost of that tied up capital. Of the first 1,000 stores Starbucks opened, it only had to close two stores because of poor site-selection.<sup>196</sup>

Overall, Starbucks' approach to store visits, whether through direct involvement, Open Forums, or mystery shoppers, reflects its commitment to customer satisfaction and operational excellence. We believe that by staying connected with its stores in various ways and knowing what competitors are doing, Starbucks can identify areas for improvement and reinforce its core values across its global network.

## Investment Context and Competitive Landscape

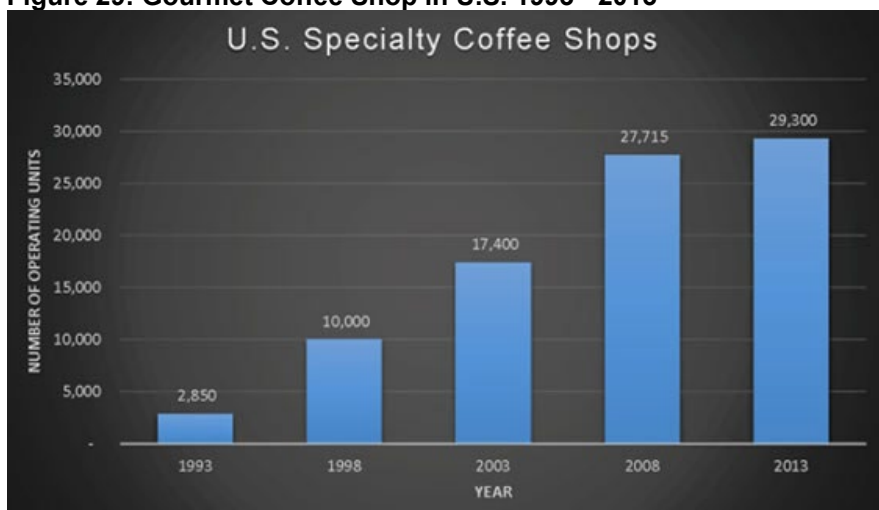
### Why Starbucks Beat the Competition?

Several factors helped Starbucks stand out among competitors. Despite a broader decline in the coffee industry and decreasing average daily consumption due to factors like low-quality coffee from major manufacturers, the rise of carbonated beverage substitutes, and health concerns related to coffee, **the specialty coffee segment continued to grow. Retail sales of gourmet coffee rose from \$210 million in 1983 to an estimated \$675 million in 1989, representing over 10% of all coffee sales and making it the only segment in the coffee market that continued to grow.**<sup>197</sup>

Starbucks' store sales in 1989 were about \$16 million,<sup>198</sup> representing an estimated 2% market share in the gourmet coffee market in the U.S. The company expected the gourmet coffee segment to grow by 9% annually to \$1.05 billion by 1994, while the premium coffee market was projected to grow by 19% annually to \$681 million over the same period.<sup>199</sup> **Furthermore, according to the Specialty Coffee Association, as Figure 29 shows, the number of specialty coffee shops in the United States grew from 2,850 in 1993 to over 10,000 by 1998, indicating a significant expansion in the total addressable market for specialty coffee.**

While many believed that coffee businesses were confined to local markets, Starbucks saw a much broader opportunity. The company identified that its high-quality coffee and unique in-store experience could drive its success in different regions. By expanding into new areas at an early stage, Starbucks was able to test its strategy, refine its approach, and ultimately gain a competitive advantage in a growing segment of the coffee market. This forward-thinking perspective, combined with a commitment to product quality and customer experience, set Starbucks apart from other coffee shops and helped it establish a strong foothold in the industry.

**Figure 29: Gourmet Coffee Shop in U.S. 1993 - 2013<sup>200</sup>**



Note:

<sup>196</sup> Chapter 10, Pour Your Heart Into It.

<sup>197</sup> Boom in Fancy Coffee Pits Big Marketers, WSJ. 11/06/1989.

<sup>198</sup> Starbucks Prospectus

<sup>199</sup> Pg. 17, Starbucks Prospectus.

<sup>200</sup> Specialty Coffee Association.

1. Specialty coffee shops in the above chart are defined as businesses deriving 55% or more of total revenue from the sale of coffee, coffee beverages, and coffee accessories.<sup>201</sup>

Starbucks aimed to be the first in every market if it could.<sup>202</sup> After establishing a strong presence in Seattle with its second store, Starbucks ventured beyond its city of origin by opening its third store in Vancouver, Canada, signaling its first international expansion. The company also broke away from the West Coast by opening its first store in Chicago, just two years after Il Giornale, the precursor to Starbucks, was founded. Starbucks then opened three more stores in Chicago in quick succession. Although the Chicago stores initially lost money, partly because they were in a new market and offered a different style of coffee, Starbucks began to turn a profit after 1990 as more people in Chicago embraced dark-roasted coffee.<sup>203</sup> This success demonstrated Starbucks' ability to pioneer new markets.

As Starbucks expanded into new markets and reinforced its presence in existing ones, its brand image grew stronger, potentially easing future expansions. The company's national mail-order business played a key role in nurturing loyal customers and building Starbucks' brand awareness across America, even before physical stores were opened in new markets. Mail-order buyers were often among the most loyal customers because they had to make a special effort to acquire Starbucks coffee.<sup>204</sup>

**In 1991, even before Starbucks opened its first store in Los Angeles, the Los Angeles Times had already named it the best coffee in America.**<sup>205</sup> This early recognition, alongside the success of its mail-order business, helped pave the way for Starbucks' continued expansion and demonstrated the effectiveness of the company's approach to building brand loyalty and market presence.

Starbucks' strategy worked not only in North America but also internationally. In 1996, Starbucks opened its first store in Tokyo's Ginza District, marking its first venture outside North America. Even before the store's grand opening, Japanese coffee companies were feeling the pressure. Then-Doutor manager Katsuyuki Momoï commented to Wall Street Journal reporter Norihiko Shirouzu that Starbucks was "frightening".<sup>206</sup> "They're a big threat and could take customers away from us."<sup>207</sup> The first day in Ginza was a success, with a diverse crowd lining up: business professionals, elegantly dressed women, and students with backpacks, all enduring the sweltering heat for a taste of Starbucks' coffee.<sup>208</sup>

Howard Schultz, in his memoir, offers insights into another critical factor contributing to Starbucks' success: a conservative approach to debt. He believed that taking on debt was not the best strategy for funding the company's expansion. Instead, he focused on raising capital through equity.<sup>209</sup> Before Schultz acquired Starbucks, the original founders bought Peet's Coffee & Tea through heavy borrowing, resulting in a debt-to-equity ratio of 6:1, or 600%.<sup>210</sup> Although this acquisition expanded then-Starbucks' reach into the Californian market, where Peet's was based, it left the company so heavily leveraged that there was little room for growth or innovation. This debt burden led to restricted operations, halted bonuses, and damaged the trust between employees and the company.

As Starbucks' marketing director at the time, Howard Schultz had envisioned transforming the company, which mainly sold whole-bean coffee, into an Italian-style coffeehouse. However, his idea was rejected by the original founder due to the company's massive debt load. "We are too deeply in debt to consider pursuing this idea. Even if we wanted to, we couldn't afford to," was the response Schultz received.<sup>211</sup>

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<sup>201</sup> Specialty Coffee Association.

<sup>202</sup> Chapter 8. Pour Your Heart Into It.

<sup>203</sup> Our First Store in Chicago. <https://archive.starbucks.com/record/our-first-store-in-chicago>

<sup>204</sup> Chapter 8. Pour Your Heart Into It.

<sup>205</sup> Chapter 8. Pour Your heart Into It.

<sup>206</sup> Starbucks Debut in Ginza in 1996. <https://japantoday.com/category/features/when-they-opened-in-japan/starbucks-debuts-in-ginza-in-1996>

<sup>207</sup> Starbucks Debut in Ginza in 1996. <https://japantoday.com/category/features/when-they-opened-in-japan/starbucks-debuts-in-ginza-in-1996>

<sup>208</sup> Starbucks Debut in Ginza in 1996. <https://japantoday.com/category/features/when-they-opened-in-japan/starbucks-debuts-in-ginza-in-1996>

<sup>209</sup> Chapter 4. Pour Your Heart Into It.

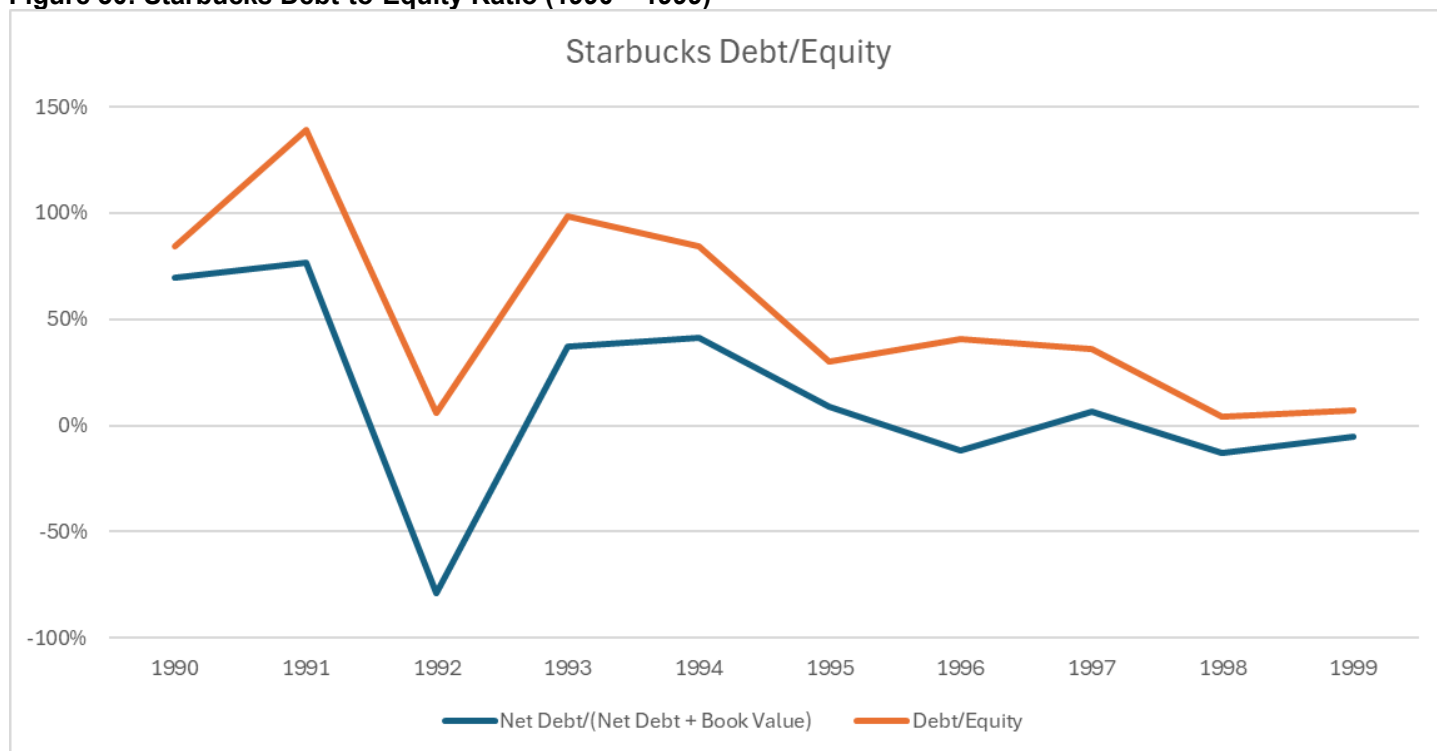
<sup>210</sup> Chapter 4. Pour Your Heart Into It.

<sup>211</sup> Chapter 4. Pour Your Heart Into It.

We believed that it's possible that Starbucks' heavy indebtedness played a role in Howard Schultz's later acquisition of the company. Jerry Baldwin recalled that a poor hiring choice for Chief Operating Officer also played a role in the decision to give up Starbucks and retain Peet's.<sup>212</sup> After acquiring Starbucks, as Figure 30 shows, Schultz reduced the company's debt-to-equity ratio, which declined from over 100% in 1991 to close to 0% in 1999 as the company expanded and became more profitable with net earnings grew from \$0.9 million to \$101.7 million. This shift towards financial stability facilitated Starbucks' rapid expansion and allowed the company to offer generous benefits packages to its employees. This commitment to employee well-being and the resulting high morale fostered loyalty, reduced turnover rates, and helped build a resilient and cohesive workforce, which further fueled the company's growth and success.

Raising capital through equity is not risk-free. Martin Diedrich sought funds for expansion and opted to trade 45% of his company's shares for a \$1 million investment from an external investor.<sup>213</sup> However, subsequent rounds of dilution decreased his ownership to less than 3%, ultimately leading to his loss of control over the company. The new investors steered away from Diedrich's established business principles with neglected customer service, insufficient training for new hires, and compromised product quality by implementing cost-cutting measures such as capping prices on coffee beans that he could purchase. This downward spiral resulted in a dramatic loss in customers.<sup>214</sup>

**Figure 30: Starbucks Debt-to-Equity Ratio (1990 – 1999)<sup>215</sup>**



**Figure 31: Starbucks Interest Coverage Ratio**

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
<b>EBITDA/Interest Expense</b>	438.0x	-253.8x	50.2x	21.0x	-22.2x	21.5x	42.1x	28.6x	26.6x	36.1x
<b>Net Debt/EBITDA</b>	5.4x	4.1x	-3.2x	2.6x	2.1x	0.5x	-0.5x	0.3x	-0.5x	-0.2x

Notes:

1. Net Debt = (Short-term Debt + Long-term Debt) – Cash
2. The negative values in 1991 and 1994 were due to net interest income.
3. Starbucks had net cash in 1992, 1996, 1998, and 1999.

One key reason Starbucks became a national brand while competitors did not is that, for many customers, coffee shops were merely functional places to grab a cup of coffee in the morning. Starbucks transformed this perception by offering an

<sup>212</sup> Discussion with Jerry Baldwin.

<sup>213</sup> Discussion with Martin Diedrich.

<sup>214</sup> Discussion with Martin Diedrich.

<sup>215</sup> Starbucks Annual Report 1990-1999.

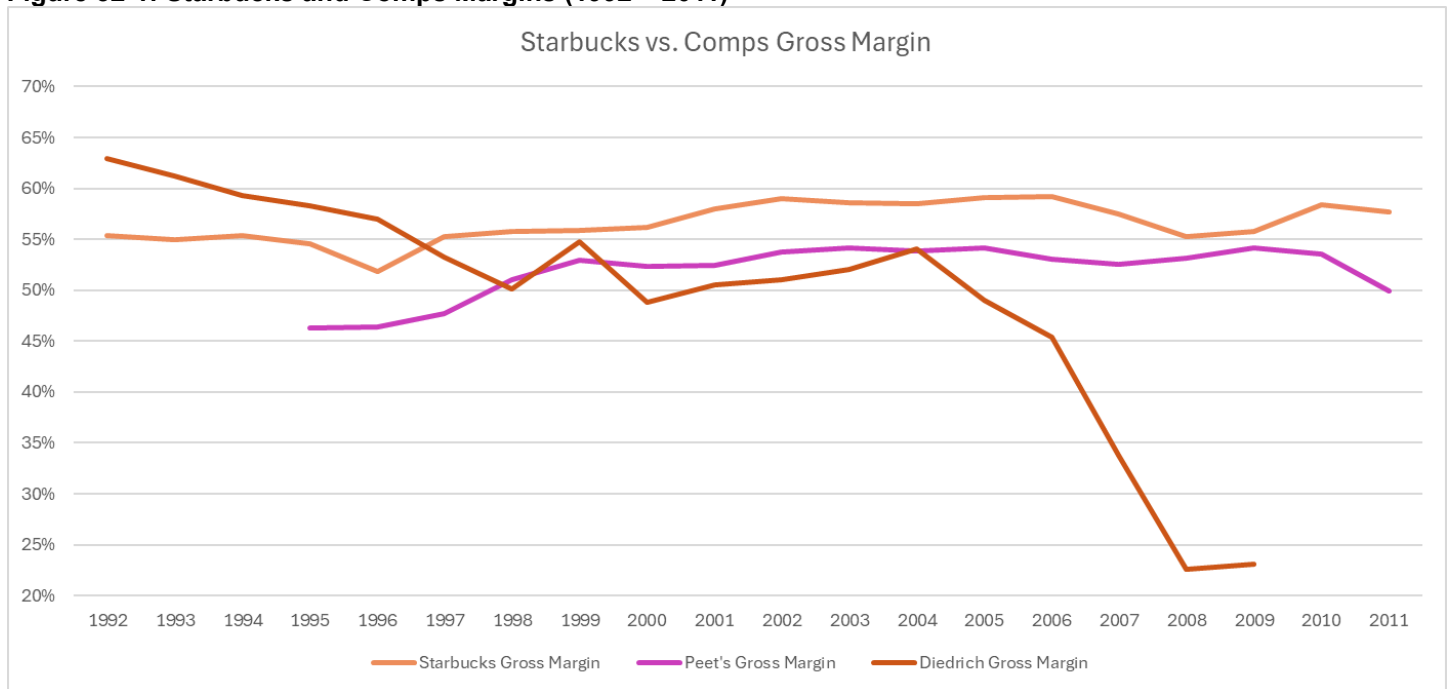
in-store experience that went beyond just serving coffee—it added emotional value to the high-quality coffee it sold. In the late 1980s, while raising capital for his coffeehouse concept, Howard Schultz was told by a potential investor that "Americans are never going to spend a dollar and a half for coffee."<sup>216</sup> Yet by 1992, before Starbucks went public, it already had over 120 stores with coffee prices ranging from \$0.65 to \$2.85 per cup and whole-bean coffee prices ranging from \$6.75 to \$14.25 per pound, significantly higher than the national average of less than \$3 per pound.

The premium Starbucks was able to charge wasn't just because of its high-quality coffee, but also because of its brand image, which included emotional value. Howard Schultz believed that to build a successful retail brand, you needed to create awareness and attract people's favorable attention.<sup>217</sup> Starbucks did this by fulfilling deeper needs. As urbanization progressed, part of the community life in the U.S. faded, and people yearned for a "Third Place" between home and work—a comfortable space for casual social interactions and relaxation. Starbucks met this need in several ways:<sup>218</sup>

1. A Taste of Romance: By offering high-quality coffee made from exotic beans from places like Sumatra and Costa Rica, Starbucks added a sense of romance to what might otherwise be just a morning routine;
2. Affordable Luxury: Starbucks offered a sense of luxury that was accessible to a broader demographic. A utility worker could enjoy the same high-quality coffee as a wealthy surgeon, even if he couldn't afford a luxury car;
3. An Oasis: Starbucks created an inviting, comfortable, and harmonious environment for customers to enjoy their coffee, providing a brief escape from the chaos of daily life; and
4. Casual Social Interactions: Starbucks' welcoming environment facilitated casual social interactions, contributing to a sense of community and connection.

Starbucks' strong brand image has allowed it to continue expanding its retail business and charging a premium over other coffee shops. Although direct data on product prices is not readily available for comparison, Starbucks' gross margin has consistently increased as it expanded, while its competitors' margins have generally remained lower, as shown in Figure 32. This consistent growth and strong brand image underscore Starbucks' successful approach to creating a unique coffee experience that resonates with customers.

**Figure 32-1: Starbucks and Comps Margins (1992 – 2011)**



Note:

<sup>216</sup> Chapter 4, Pour Your Heart Into It.

<sup>217</sup> Chapter 8, Pour Your Heart Into It.

<sup>218</sup> Chapter 8, Pour Your Heart Into It.

1. Diedrich started in 2005 to either close or sell their retail stores to other companies such as Starbucks in the U.S., and Gloria Jean in the international markets, and other parties. The company wanted to focus on wholesale business.<sup>219</sup>

**Figure 32-2: Starbucks and Comps Gross Margins Table (1992 – 2011)**

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
<b>Starbucks Gross Margin</b>	55.4%	55.0%	55.3%	54.6%	51.8%	55.3%	55.8%	55.9%	56.2%	58.0%
<b>Peet's Gross Margin</b>				46.3%	46.4%	47.7%	51.0%	52.9%	52.3%	52.4%
<b>Diedrich Gross Margin</b>	62.9%	61.2%	59.3%	58.3%	57.0%	53.2%	50.1%	54.8%	48.8%	50.6%
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Starbucks Gross Margin</b>	59.0%	58.6%	58.5%	59.1%	59.2%	57.5%	55.3%	55.8%	58.4%	57.7%
<b>Peet's Gross Margin</b>	53.7%	54.1%	53.9%	54.1%	53.0%	52.5%	53.1%	54.1%	53.6%	49.9%
<b>Diedrich Gross Margin</b>	51.1%	52.0%	54.0%	49.1%	45.4%	33.8%	22.6%	23.1%		

Notes:

1. Limited data on Peet's because it went public in 2001 and became private in 2012.
2. Limited data on Diedrich because it went public in 1996 and acquired by Green Mountain Coffee Roasters in 2009.

Starbucks is dedicated to maintaining high quality, but it's also open to exploring new business lines and accommodating customer requests when they present a reasonable opportunity. This flexibility is not just about boosting sales; sometimes, it's about strengthening the connection with customers and evolving to meet their needs. Other companies might resist change or prefer to stick with the status quo, but Starbucks' approach is more adaptive.

We can infer the company's willingness to embrace change from the experience Howard Schultz had with Starbucks' founders. After visiting Italy, Schultz saw a growing demand for Italian-style coffeehouses in the U.S. He proposed to the then-founders of Starbucks to expand into this concept, but after several discussions, they declined.<sup>220</sup>

“But why? [why not open coffee houses?]” said Howard Schultz.

“It's too risky, too much change... Your plans sound great, but that's just not the vision we have for Starbucks.”

This rejection led Schultz to start his own coffee business, Il Giornale, which eventually merged with Starbucks, paving the way for the company's transformation into the coffeehouse chain it is today.

**Starbucks' readiness to explore new ideas and respond to customer trends has played a significant role in its growth and success.** While some competitors might be hesitant to deviate from traditional models, Starbucks' culture of innovation and customer-centric approach has allowed it to capitalize on opportunities and build a strong brand that resonates with diverse customer needs.

After joining Starbucks and taking on the role of marketing director, Howard Schultz proposed to the company once again the idea of opening Italian-style coffeehouses and serving espresso beverages in-house, rather than limiting their offerings to whole-bean coffee sales. Jerry Baldwin, one of Starbucks' founders, declined the proposal.<sup>221</sup> This decision highlighted the different visions within the company: Schultz saw the potential in creating a more engaging in-store experience with espresso-based drinks, while the founders preferred to maintain their focus on retailing whole-bean coffee.

Despite the rejection, Schultz's belief in the concept led him to pursue the idea on his own, founding Il Giornale, an espresso bar in Seattle. This step would eventually lead to the merging of Il Giornale with Starbucks, allowing Schultz's vision to reshape the company's future, transforming it into the globally recognized coffeehouse chain it is today. Schultz's persistence and innovative mindset became crucial in setting the new direction for Starbucks, showing the importance of adapting to customer needs and evolving business models.

“It could be so much bigger than that,” said Howard Schultz.<sup>222</sup>

“Starbucks doesn't need to be any bigger than it is. If you get too many customers in and out, you can't get to know them the way we always have,” said Jerry Baldwin.

<sup>219</sup> Starbucks Buys Diedrich Stores. <https://www.globest.com/sites/globest/2006/09/17/starbucks-buys-diedrich-stores/?slreturn=20240401171333>

<sup>220</sup> Chapter 3, Pour Your Heart Into It.

<sup>221</sup> Chapter 4, Pour Your Heart Into It.

<sup>222</sup> Chapter 4, Pour Your Heart Into It.

"In Italy, the baristas know their customers."

"I'm sorry, Howard. We aren't going to do it. You'll have to live with that."

Jerry Baldwin's reluctance to consider expanding Starbucks beyond its whole-bean coffee focus stemmed from a concern that growth would impact the personalized customer service that was part of the company's culture. Starbucks, however, has always been open to evolving and responding to market demand, even if it meant challenging tradition. **The company's philosophy of "just say yes"<sup>223</sup> to customer requests aligns with its commitment to satisfying customer needs, whether or not those requests directly translate into immediate sales.**

An example of this flexibility is when some customers began asking for nonfat milk, a common condiment in other coffee shops but considered "bastardizing" authentic Italian-style coffee by some purists within Starbucks. During an internal discussion, an employee defended the traditional approach, saying, "That's not in keeping with the quality of our coffee." Howard Behar, then vice president of sales and operations, strongly disagreed: "Are you nuts? Of course we'll do what they want us to." He was among those who pushed for finding ways to give customers what they wanted, even if it was unpopular with coffee purists.<sup>224</sup>

Starbucks eventually added nonfat milk to its list of condiments, and soon, almost half of its lattes and cappuccinos were made with it. This adaptation illustrates that even a simple change, like adding a new condiment, can make a significant difference in customer satisfaction. It might not directly boost sales, but it can prevent customers from turning to competitors and attract new ones by offering more choices. Ultimately, this approach contributes to building a brand that values customer preferences and encourages loyalty.

Starbucks has built a strong customer loyalty over the years by embracing customer preferences without sacrificing the quality of its core product, which is coffee. The company is flexible in meeting customer demands as long as they do not compromise its foundational principles. This adaptability allows Starbucks to create new offerings and address customer requests while maintaining the integrity of its coffee.

Starbucks has also fostered customer loyalty through subtle but impactful ways, approaches that not only many competitors didn't employ but also non-coffee companies often overlooked. The company began by offering high-quality coffee and authentic Italian-style espresso beverages, attracting new customers. Given the high employee turnover rate typical in retail and fast-food chains, Starbucks recognized the importance of retaining employees who build relationships with customers. Starbucks estimated that it cost around \$3,000<sup>225</sup> to train a new employee in the late 1980s, at a time when an espresso drink at Starbucks cost about \$2. High turnover not only incurs training costs but also risks losing loyal customers if they follow a departing barista to a competitor.

Understanding that employee satisfaction is key to customer satisfaction, Starbucks has focused on treating employees like family. In 1988, the company became the first private company, and later the first public company, to offer full health benefits to both full- and part-time employees working over 20 hours a week. This approach, along with the Employee Stock Ownership Program, or "Bean Stock," made employees stakeholders in the company's success. By offering these benefits, Starbucks hoped to foster a sense of ownership and loyalty among employees.

This focus on employee well-being and partnership might increase operating expenses, but it also reduces long-term training costs and retains talented employees, who in turn retain loyal customers. It also enhances the company's execution capacity because employees are more likely to think like business owners. The consistent treatment of employees has helped Starbucks maintain a relatively low turnover rate: 60% to 65% for baristas and 25% for store managers, compared to 50% or more for other retailers.<sup>226</sup>

While direct comparisons of employee benefit costs are challenging, examining Starbucks' operating expenses provides some insight. As Figure 33 shows, from 1992 to 2011, Starbucks' operating expenses were consistently a few percentage points higher than those of its competitors, typically ranging from 35% to 38% of overall sales. This stability potentially suggests that Starbucks' investment in its human capital had a positive impact, maintaining a relatively consistent employee base and creating a culture of loyalty and dedication that drives the company's long-term success.

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<sup>223</sup> Chapter 12, Pour Your Heart Into It.

<sup>224</sup> Chapter 12, Pour Your Heart Into It.

<sup>225</sup> Chapter 9, Pour Your Heart Into It.

<sup>226</sup> Chapter 9, Pour Your Heart Into It.

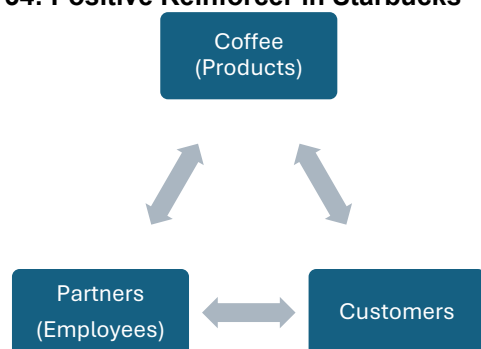
**Figure 33: Starbucks vs. Comps Operating Expense (ex. COGS) as Percentage of Sales**

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
<b>Starbucks Operating Expense (ex. COGS) as % of Sales</b>	36%	36%	36%	35%	33%	35%	35%	35%	36%	37%
<b>Peet's Operating Expense (ex. COGS) as % of Sales</b>				26%	28%	29%	31%	32%	33%	32%
<b>Diedrich Operating Expense (ex. COGS) as % of Sales</b>	32%	36%	39%	38%	37%	43%	47%	40%	36%	29%
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Starbucks Operating Expense (ex. COGS) as % of Sales</b>	38%	37%	37%	37%	38%	37%	39%	38%	36%	35%
<b>Peet's Operating Expense (ex. COGS) as % of Sales</b>	32%	32%	33%	34%	34%	34%	35%	34%	33%	30%
<b>Diedrich Operating Expense (ex. COGS) as % of Sales</b>	28%	31%	31%	33%	34%	26%	19%	7%		

Notes:

1. Limited data on Peet's because it went public in 2001 and became private in 2012.
2. Limited data on Diedrich because it went public in 1996 and acquired by Green Mountain Coffee Roasters in 2009.

**Figure 34: Positive Reinforcer in Starbucks**



Note:

1. Graphed by author for illustration purpose.

**Figure 35: Debt Levels and Coverage**

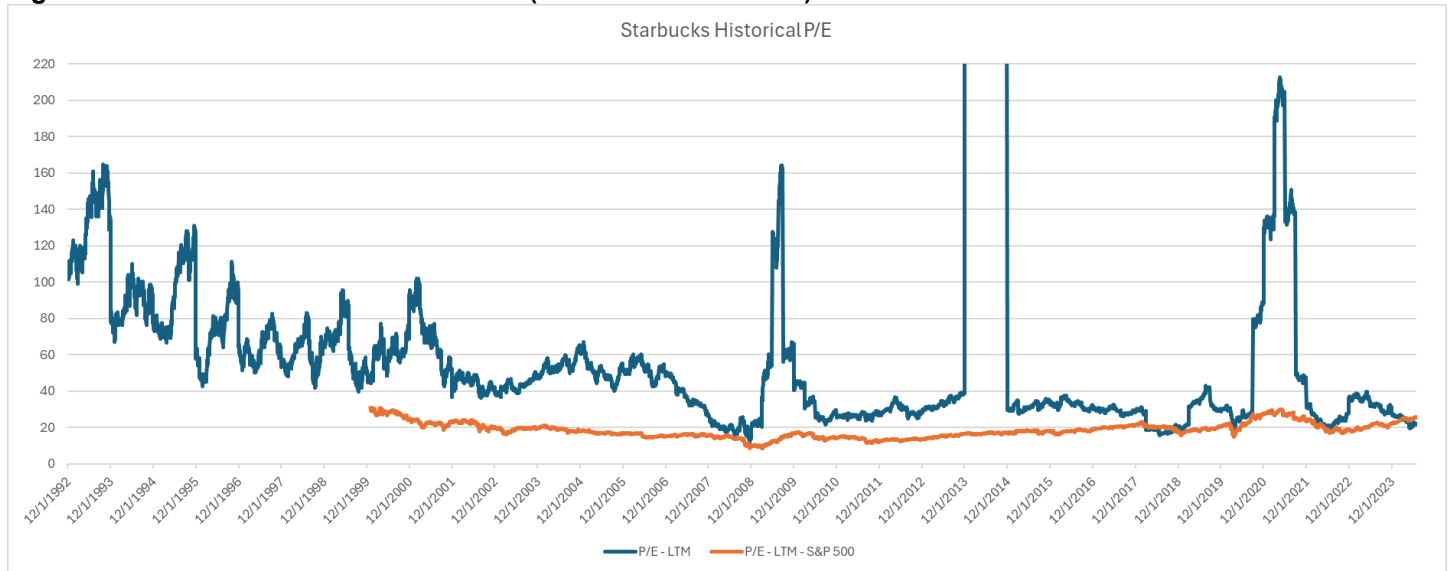
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
EBIT	0.8	2.9	6.4	13.0	23.3	40.1	57.0	88.2	109.2	156.7	220.6	281.1
EBITDA	2.6	5.8	10.5	19.8	37.3	64.9	96.4	146.4	190.1	264.2	362.8	458.2
Interest Expense	0.0	(0.0)	0.2	0.9	(1.7)	3.0	2.3	5.1	7.1	7.3	7.1	10.8
Net Debt	14.2	23.9	(33.2)	52.2	76.5	31.1	(48.2)	37.2	(89.9)	(46.6)	(68.7)	(152.1)
EBITDA/Interest Expense	438.0x	-253.8x	50.2x	21.0x	-22.2x	21.5x	42.1x	28.6x	26.6x	36.1x	51.0x	42.6x
Net Debt/EBITDA	5.4x	4.1x	-3.2x	2.6x	2.1x	0.5x	-0.5x	0.3x	-0.5x	-0.2x	-0.2x	-0.3x
Net Debt/(Net Debt + Book Value)	69%	77%	-79%	37%	41%	9%	-12%	7%	-13%	-5%	-6%	-12%
Debt/Equity	84%	139%	6%	98%	84%	30%	41%	36%	4%	7%	6%	5%
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
EBIT	318.7	424.7	610.1	780.6	894.0	1,053.9	503.9	562.0	1,419.4	1,728.5	1,997.4	(325.4)
EBITDA	539.9	684.0	924.2	1,147.8	1,306.6	1,545.2	1,108.4	1,125.3	1,960.2	2,278.5	2,578.0	330.2
Interest Expense	9.3	11.6	14.1	15.8	12.3	2.4	(44.4)	(2.8)	17.6	82.6	61.7	95.5
Net Debt	(320.5)	(343.9)	(640.5)	156.0	501.2	1,159.3	1,368.2	273.0	(525.2)	(1,153.4)	(1,142.1)	(1,576.7)
EBITDA/Interest Expense	58.1x	58.9x	65.4x	72.5x	106.3x	638.8x	-25.0x	-401.9x	111.4x	27.6x	41.8x	3.5x
Net Debt/EBITDA	-0.6x	-0.5x	-0.7x	0.1x	0.4x	0.8x	1.2x	0.2x	-0.3x	-0.5x	-0.4x	-4.8x
Net Debt/(Net Debt + Book Value)	-23%	-20%	-35%	7%	18%	33%	35%	8%	-17%	-36%	-29%	-54%
Debt/Equity	5%	0%	0%	13%	31%	55%	50%	18%	15%	13%	11%	29%
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023		
EBIT	3,081.1	3,601.0	4,171.9	4,134.7	3,883.3	4,077.9	1,561.7	4,872.1	4,617.8	5,870.8		
EBITDA	3,829.5	4,534.8	5,202.0	5,201.8	5,189.2	5,527.2	3,064.9	6,396.2	6,147.2	7,321.1		
Interest Expense	78.6	(27.5)	26.7	182.8	21.1	(234.5)	(397.3)	(379.7)	(385.9)	(468.9)		
Net Debt	596.7	1,361.4	2,028.7	1,992.6	1,932.8	9,780.4	13,872.3	9,987.0	13,717.2	13,235.8		
EBITDA/Interest Expense	48.7x	-164.9x	194.8x	28.5x	245.9x	-23.6x	-7.7x	-16.8x	-15.9x	-15.6x		
Net Debt/EBITDA	0.2x	0.3x	0.4x	0.4x	0.4x	1.8x	4.5x	1.6x	2.2x	1.8x		
Net Debt/(Net Debt + Book Value)	10%	19%	26%	27%	62%	276%	228%	214%	273%	252%		
Debt/Equity	39%	40%	61%	72%	803%	-179%	-324%	-444%	-274%	-308%		

Note:

1. The depreciation and amortization cost used in calculation is from the cashflow statements instead of the income statement.

## 2. Is the Stock Cheap?

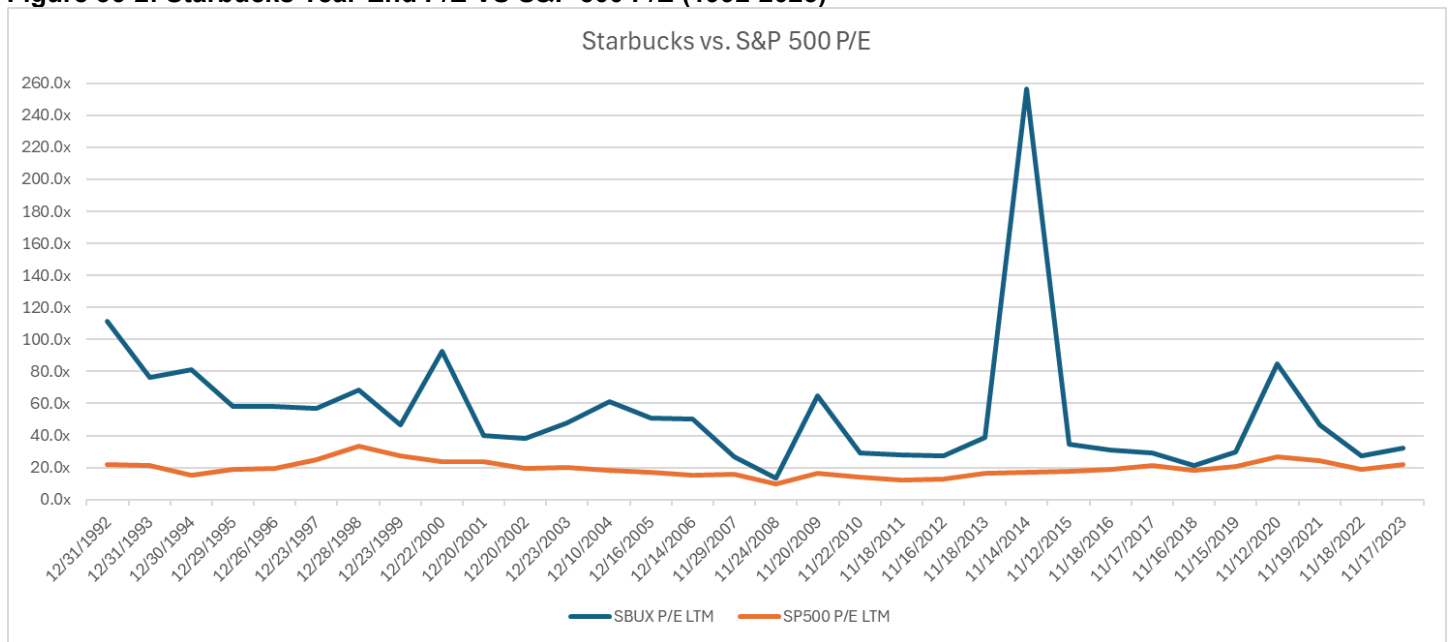
**Figure 36-1: Starbucks Valuation Metrics (12/1/1992 – 6/30/2024)<sup>227</sup>**



**Notes:**

1. Daily Starbucks' P/E ratios on Factset only available starting 12/01/1992.
2. Daily S&P 500 P/E ratios on Factset only available starting 12/31/1999.

**Figure 36-2: Starbucks Year-End P/E VS S&P 500 P/E (1992-2023)<sup>228</sup>**



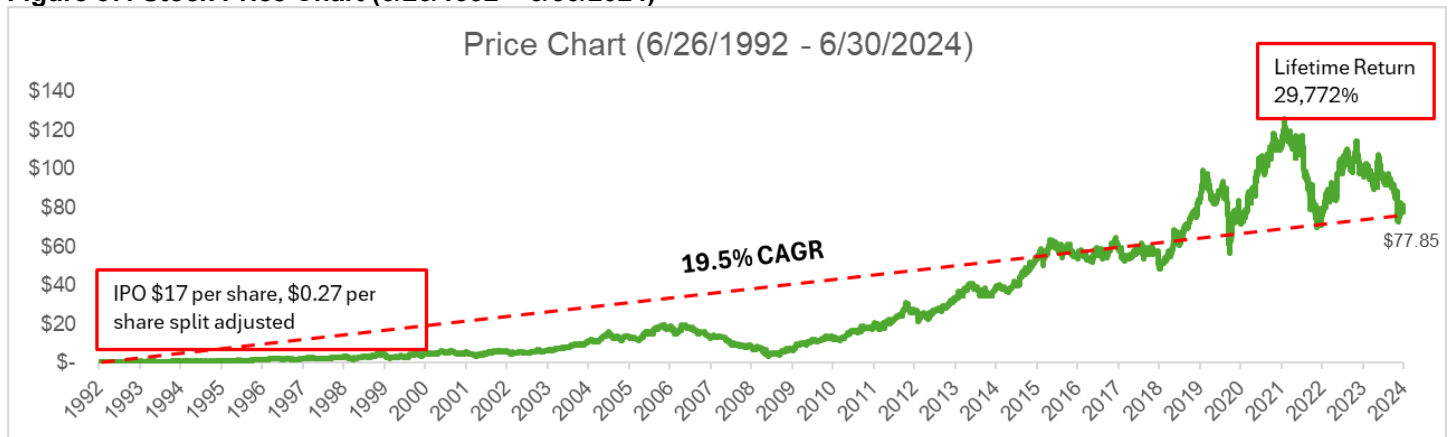
**Notes:**

1. Starbucks P/E data from Factset; S&P 500 monthly data prior to 1999 from Macrotrend.com, and post-1999 from Factset.
2. P/E ratios for Starbucks are as of the day Starbucks filed its 10K with SEC, except for 1992-1995, which the dates are unknown because of data limitations on the SEC website. We use ratios at the end of December during 1992-1995.
3. Starbucks' PE ratio in 2014 was high because a litigation charge nearly \$2.8 billion in the previous year with Kraft Foods Global.

<sup>227</sup> Factset.

<sup>228</sup> Factset; Macrotrend.com.

**Figure 37: Stock Price Chart (6/26/1992 – 6/30/2024)<sup>229</sup>**



**Peer Group Valuation Analysis**

When Starbucks went public in 1992, there were no other publicly traded companies in the coffeehouse industry that were closely comparable. Diedrich Coffee and Peet's Coffee, two of Starbucks' closest competitors, did not go public until 1996 and 2000, respectively. This lack of publicly listed peers at the time potentially meant that Starbucks was a unique player in the market, with little direct comparison for investors. As a result, the company had the opportunity to set its own path and establish a leadership position in the industry. This unique position contributed to Starbucks' early growth and the development of its strong brand identity.

Throughout the period when Starbucks, Diedrich, and Peet's were publicly traded, Diedrich consistently reported negative P/E due to the net losses for most of those years, as depicted in Figure 38-3. From 2001 to 2011, Starbucks in general commanded a higher valuation compared to Peet's. At the end of each fiscal year, Starbucks typically traded at an average P/E ratio of 41x, a 14% premium over Peet's average 36x. This discrepancy reflected Starbucks' growth and development over the years, highlighting its trajectory of development.

**Figure 38-1: Starbucks vs. Comps. P/E**

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Starbucks EPS	0.56	0.51	0.48	0.56	0.69	0.99	0.63	0.74	0.9	0.43	0.53	1.27	1.66
YoY Growth	-28.2%	-8.9%	-5.9%	16.7%	23.2%	43.5%	-36.4%	17.5%	21.6%	-52.2%	23.3%	139.6%	30.7%
Starbucks P/E	46.8x	92.4x	40.0x	38.4x	47.9x	61.1x	51.1x	50.1x	26.5x	13.4x	64.9x	28.9x	27.6x

Notes:

1. P/E ratios are derived on the day of the fiscal year earnings report release.
2. N/A indicates that the company had a negative P/E during the fiscal year because of net losses.

**Figure 38-2: Starbucks vs. Comps. P/E**

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Diedrich EPS	\$ (0.43)	\$ (1.80)	\$ (1.16)	\$ 0.25	\$ (0.24)	\$ 0.05	\$ (0.64)	\$ (1.47)	\$ (0.33)	\$ (2.52)	\$ 0.29	\$ -	\$ -
YoY Growth	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Diedrich P/E	N/A	N/A	N/A	16.2x	N/A	98.0x	2.9x	N/A	N/A	N/A	68.4x	N/A	N/A

Notes:

1. P/E ratios are derived on the day of the fiscal year earnings report release.
2. N/A indicates that the company had a negative P/E during the fiscal year because of net losses.
3. On 2/11/2005, Diedrich sold its Gloria Jean's international franchise operations to an Australia company, offset the EPS of -\$0.64 from continuing operations.
4. Diedrich went public in 1996 and acquired by Green Mountain Coffee Roasters in 2009.

**Figure 38-3: Starbucks vs. Comps. P/E**

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Peet's EPS	\$ (0.03)	\$ (0.50)	\$ 0.14	\$ 0.40	\$ 0.39	\$ 0.63	\$ 0.74	\$ 0.55	\$ 0.59	\$ 0.80	\$ 1.44	\$ 1.28	\$ 1.33
YoY Growth	#N/A	#N/A	#N/A	185.7%	-2.5%	61.5%	17.5%	-25.7%	7.3%	35.6%	80.0%	-11.1%	3.9%
Peet's P/E	N/A	N/A	51.8x	32.3x	42.5x	33.5x	32.4x	54.0x	46.6x	25.5x	14.5x	31.9x	34.8x

<sup>229</sup> Factset.

## Notes:

1. P/E ratios are derived on the day of the fiscal year earnings report release.
2. N/A indicates that the company had a negative P/E during the fiscal year because of net losses.

While the stated LTM P/E at the time of Starbucks IPO was 76x, it is important to note that Starbucks only operated 126 locations and had an estimated market share of 2% in U.S. gourmet coffee in 1989. If one believed that Starbucks could achieve just 10% market share, which was about 5 times of its current market share in the US, and maintain its current net margins, the price to earnings ratio would be closer to 15.0x.

**Figure 39: Starbucks Income vs. Multiple**

(\$Million, except for per share data)	1992	1993	1994	1995	1996	1997	1998	1999
<i>Comparable Store Sales</i>	20.8%	20.2%	9.0%	9.0%	7.0%	5.0%	5.0%	6.0%
<i>Number of Stores</i>	154	253	425	676	1,006	1,381	1,886	2,498
<b>Company-operated stores</b>	81.1	142.4	248.5	402.7	600.1	828.1	1,102.6	1,423.4
<b>Licensing</b>	-	-	-	-	-	-	-	-
<b>Food service and other</b>	12.0	21.1	36.4	62.6	96.4	138.9	206.1	256.8
<b>Total specialty</b>	12.0	21.1	36.4	62.6	96.4	138.9	206.1	256.8
<b>Total Revenue</b>	<b>93.1</b>	<b>163.5</b>	<b>284.9</b>	<b>465.2</b>	<b>696.5</b>	<b>966.9</b>	<b>1,308.7</b>	<b>1,680.1</b>
<b>Gross Income</b>	<b>51.6</b>	<b>89.9</b>	<b>157.7</b>	<b>253.9</b>	<b>360.7</b>	<b>534.8</b>	<b>730.2</b>	<b>939.1</b>
<i>Gross Margin</i>	55.4%	55.0%	55.3%	54.6%	51.8%	55.3%	55.8%	55.9%
<i>YoY Growth</i>	65.1%	74.4%	75.4%	61.1%	42.0%	48.3%	36.6%	28.6%
<b>Store operating expenses</b>	31.2	53.3	93.2	148.8	210.7	309.1	418.5	543.6
<i>Store operating expenses as % of Sales</i>	33.6%	32.6%	32.7%	32.0%	30.3%	32.0%	32.0%	32.4%
<b>G&amp;A Expense</b>	8.1	12.5	20.0	28.6	37.3	57.1	77.6	89.7
<i>G&amp;A expenses as % of Sales</i>	8.7%	7.6%	7.0%	6.2%	5.3%	5.9%	5.9%	5.3%
<b>EBIT</b>	<b>6.4</b>	<b>13.0</b>	<b>23.3</b>	<b>40.1</b>	<b>57.0</b>	<b>88.2</b>	<b>109.2</b>	<b>156.7</b>
<i>EBIT Margin</i>	6.8%	7.9%	8.2%	8.6%	8.2%	9.1%	8.3%	9.3%
<i>EBIT Growth</i>	119.0%	103.7%	79.6%	72.2%	42.1%	54.8%	23.8%	43.5%
<b>EBITDA</b>	<b>10.5</b>	<b>19.8</b>	<b>37.3</b>	<b>64.9</b>	<b>96.4</b>	<b>146.4</b>	<b>190.1</b>	<b>264.2</b>
<i>EBITDA Margin</i>	10.8%	11.7%	12.6%	13.5%	13.3%	14.5%	13.9%	15.1%
<i>YoY Growth</i>	79.9%	88.6%	88.4%	74.1%	48.4%	52.0%	29.8%	39.0%
<b>Net Income</b>	<b>1.5</b>	<b>8.5</b>	<b>9.9</b>	<b>26.1</b>	<b>42.1</b>	<b>57.4</b>	<b>68.4</b>	<b>101.7</b>
<i>Net Margin</i>	1.7%	5.2%	3.5%	5.6%	6.0%	5.9%	5.2%	6.1%
<i>YoY Growth</i>	69.9%	452.5%	16.9%	162.7%	61.4%	36.3%	19.1%	48.7%
<b>Split Adjusted EPS</b>	0.00	0.01	0.01	0.02	0.03	0.04	0.05	0.07
<i>YoY Growth</i>		373.5%	13.5%	120.1%	49.5%	28.5%	10.4%	44.0%
<b>Split Adjusted Shares Outstanding</b>	796.0	928.9	956.1	1,140.9	1,231.4	1,306.2	1,408.9	1,454.7
<i>YoY Growth</i>		16.7%	2.9%	19.3%	7.9%	6.1%	7.9%	3.3%
<b>Split Adjusted Dividends per Share</b>	-	-	-	-	-	-	-	-
<i>YoY Growth</i>								
<b>Forward Split Adjusted P/E</b>	137.4x	29.0x	25.6x	11.6x	7.8x	6.0x	5.5x	3.8x
Split Adjusted IPO Price	\$ 0.27							

## Why did others miss the investment?

1. *Not cheap on traditional metrics.* Since going public in 1992, the coffee giant has consistently commanded high P/E ratios, well above the market average. Over the span of more than two decades post-IPO, Starbucks has maintained an average P/E ratio of over 50x, significantly surpassing the S&P 500's typical ratio of 20x. In fact, even at its inception in 1992, Starbucks boasted an implied P/E ratio of over 50x based on its IPO price and fiscal year 1992 earnings.

It's worth noting that even though the company grew rapidly in the following years, Starbucks' P/E ratio remained notably higher than the historical range of the S&P 500, which typically fluctuates between 15x to 20x.

**Figure 40: Starbucks vs. S&P 500 P/E**

Date	SBUX P/E LTM	SP500 P/E LTM
12/31/1992	111.2x	22.1x
12/31/1993	76.4x	21.2x
12/30/1994	81.1x	15.0x
12/29/1995	58.3x	18.7x
12/26/1996	58.3x	19.5x
12/23/1997	56.8x	24.8x
12/28/1998	68.4x	33.3x
12/23/1999	46.8x	27.4x
12/22/2000	92.4x	23.8x
12/20/2001	40.0x	23.5x
12/20/2002	38.4x	19.5x
12/23/2003	47.9x	20.1x
12/10/2004	61.1x	18.2x
12/16/2005	51.1x	16.8x
12/14/2006	50.1x	15.4x
11/29/2007	26.5x	15.7x
11/24/2008	13.4x	9.9x
11/20/2009	64.9x	16.7x
11/22/2010	28.9x	14.1x
11/18/2011	27.6x	12.3x
11/16/2012	27.1x	12.8x
11/18/2013	38.5x	16.6x
11/14/2014	256.6x	17.0x
11/12/2015	34.5x	17.9x
11/18/2016	31.2x	18.7x
11/17/2017	28.9x	21.1x
11/16/2018	21.4x	18.1x
11/15/2019	29.9x	20.6x
11/12/2020	84.5x	26.9x
11/19/2021	46.4x	24.4x
11/18/2022	27.5x	18.6x
11/17/2023	32.1x	22.1x
<b>Average</b>	<b>54.9x</b>	<b>19.5x</b>
<b>Median</b>	<b>46.6x</b>	<b>18.7x</b>
<b>Max</b>	<b>256.6x</b>	<b>33.3x</b>
<b>Min.</b>	<b>13.4x</b>	<b>9.9x</b>

Notes:

1. Starbucks P/E data from Factset; S&P 500 monthly data prior to 1999 from Macrotrend.com, and post-1999 from Factset.

2. P/E ratios for Starbucks are as of the day Starbucks filed its 10K with SEC, except for 1992-1995, which the dates are unknown because of data limitations on the SEC website. We use ratios at the end of December during 1992-1995.
3. Starbucks' PE ratio in 2014 was high because a litigation charge nearly \$2.8 billion in the previous year with Kraft Foods Global.

2. *Not much data available publicly, not many comparable examples in the market until the late 1990s or early 2000s.* Specialty coffee began gaining traction in the U.S. around the 1980s, marking a relatively “new” industry. Building a brand around coffeehouses and expanding them nationally or internationally was quite a novel concept at the time. Initially, coffee shops were seen as local businesses with limited reach beyond their local markets.

3. *Being a “commodity” and restaurant business making it hard to differentiate itself.* Given that coffee drinks are extracted from coffee beans and only a few people could taste the subtle differences among different types of coffee, it was difficult at that time for investors to believe that the company could charge a premium price on coffee and sustain the strategy.

#### **What did investors see at the time of investment?**

1. The specialty coffee market saw a significant expansion, especially as the broader U.S. market became saturated with low-quality coffee post-war. This shift towards inferior coffee likely contributed to an overall decline in coffee quality, prompting consumers to seek out higher-quality options beyond what was offered in supermarkets. This trend is evidenced by the rapid growth of the gourmet coffee segment, which surged from \$210 million in 1983 to an estimated \$675 million in 1989, constituting over 10% of total coffee sales. Remarkably, while the overall coffee market faced decline, the gourmet coffee segment continued to flourish. In 1989, Starbucks, despite modest store sales of \$16 million, held approximately 2% of the U.S. gourmet coffee market, which was highly segmented. This indicated a significant growth opportunity not only for Starbucks but also for other specialty coffee companies, given the ample runway for expansion.

2. Starbucks stood out as a people-centric company, a rarity in both the public and private sectors. It placed a strong emphasis on prioritizing its employees and customers over profits. Unlike many businesses, Starbucks went above and beyond the industry norm in terms of treating its employees well. This exceptional treatment translated into high morale and a sense of ownership among employees, fostering a genuine passion for serving customers. By nurturing strong connections with both employees and customers, Starbucks created a workplace culture that thrived on mutual respect and satisfaction.

3. At the time of its IPO, Starbucks' P/E was significantly higher than the historical 15x to 20x P/E range of the S&P 500, the specialty coffee sector was experiencing a rapid expansion. By FY1991, Starbucks transitioned from incurring net losses to generating net profits, with industry projections of a 19% annual growth rate by 1994.

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