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Starbucks' quest for healthy growth: An interview with Howard Schultz

The company once grew fast. Now CEO Howard Schultz wants it to grow with discipline—in emerging and developed markets alike.



When Howard Schultz returned to Starbucks as CEO in early 2008, after a hiatus of nearly eight years, he quickly concluded that growth had become a “carcinogen” and that the company needed a transformation in its culture and operating approach. As he was leading that change process, Schultz also chronicled it in his new book, *Onward: How Starbucks Fought for Its Life without Losing Its Soul*.¹ In this edited conversation with McKinsey’s Allen Webb, Schultz answers some of the questions raised in his book, describes the insidious impact of breakneck growth on Starbucks, and explains how he hopes to keep the company on a healthier growth trajectory. Emerging markets have a significant role to play in powering future growth. So does Starbucks’ transition into what Schultz hopes will be the first company to excel as both a retailer and a purveyor—in supermarkets and other mass-market channels—of consumer packaged goods.

The Quarterly: *In your book, you say that growth became a carcinogen at Starbucks. What do you mean by that?*

Howard Schultz: Let me try and put growth in the context of the last 15 or 20 years of Starbucks’ life, and then I’ll try and specifically answer the question. You have to understand that in 1987, Starbucks had 11 stores and 100 employees, and we had this dream to create a national brand around coffee and a unique experience in our stores that, hopefully, we would be able to extend from the West Coast to around the country.

And from that point on, the dream started becoming a reality, and it almost had a life of its own. What we were building seemed to work wherever we opened stores. We had a little bit of luck and business acumen and perhaps just the fortuitous opportunity that comes along with perfect timing. For 15-plus years or so, almost everything we did worked as we built this very unique brand around coffee and a values-based organization.

When you look at growth as a strategy, it becomes somewhat seductive, addictive. But growth should not be—and is not—a strategy; it’s a tactic. The primary lesson I’ve learned over the years is that growth and success can cover up a lot of mistakes. We’re going to make more mistakes. But we’ve learned a great lesson. And as we return the company to growth, it’ll be disciplined, profitable growth for the right reasons—a different kind of growth.

The Quarterly: *So turning the clock back to 2008, what were some of the things you were seeing that seemed carcinogenic?*

Howard Schultz: When we reviewed some of the underperforming stores, I was horrified to learn that the stores that we ultimately had to close had been open less than 18 months. When you look at that—the money invested and the money that we had to write

¹Howard Schultz, *Onward: How Starbucks Fought For Its Life without Losing Its Soul*, New York, NY: Rodale Books, 2011.

off—those decisions were made with a lack of discipline. Also, I think there were times, during that period when we were chasing growth, when we were making decisions that were kind of complicit with the stock price. That’s a very, very dangerous road to go down.

The Quarterly: *One thing you did, soon after returning, was to stop reporting same-store sales.*

Howard Schultz: Correct.

The Quarterly: *Why did you do that, and how did it work out?*

Howard Schultz: Well, there’s a fine line between trying to manage the company in the most appropriate fiduciary way—and at the same time providing analysts with 100 percent transparency, which they deserve. And I say “fine line” because you don’t want to start making decisions that are based on a P/E or stock price. However, when a P/E gets to a certain point and a stock price gets to a certain point, you begin to believe that the organization, the enterprise, is worth that. And then you get to a point where you’re managing to either uphold it or to increase it.

An albatross around the neck of most retailers and restaurant companies is this metric that Wall Street created many, many years ago: the calculation of the growth of stores open for more than one year. Taking one unit and seeing whether or not that unit is growing, year over year, is a solid case study of whether a company is healthy, but not the only one. In any event, Wall Street became enamored with this number. And as a result of that, most retailers and restaurants report comp-store sales on a monthly basis. What that does is produce tremendous fluctuation in stock prices on a monthly basis, because God forbid you get a down month.

I thought, when I came back, that we had become linked internally to the comp-store sales number, and we started making decisions that were driving incremental revenue and perhaps were not consistent with the equity of the brand. I wanted to remove that albatross from the necks of the operators.

So I announced, one day when I came back, that we were going to stop reporting monthly comps. And you would’ve thought the world came to an end. It didn’t come to an end. Now, at the time, since we were not performing, I was accused of not being transparent and trying to hide things. But what I was trying to do was make sure that our people were managing the business for the most appropriate constituent, which is the customer.

The Quarterly: *What is an example of the kind of decision making that was concerning you?*

Howard Schultz: I once walked into a Starbucks, and there was a table of teddy bears in the store that had nothing to do with coffee whatsoever. I asked the manager about this, and she said she was really enthused and excited because it was adding to her comps. You know, this doesn't make any sense.

The Quarterly: *You established an agenda when you came back—a seven-point transformation agenda. And you didn't abandon growth as part of that. In fact, one of the planks was to “create innovative growth platforms worthy of our coffee.” Why set a goal like that when just fixing your core business was such a key priority for you?*

Howard Schultz: You can't attract and retain great people for a company that isn't going to grow. No one wants to go home at night and say, “I'm working for a company that's getting transformed.” It's not very exciting. It's so vitally important to give people hope, to provide aspirations and a vision for the future. And I knew from day one that when I returned, it wasn't only going to be about restoring the company back to its original form. We had to instill a deep sense of commitment to growing the company.

The Quarterly: *What did you mean, exactly, when you said you hoped to figure out a different way of growth for Starbucks, a different growth pattern?*

Howard Schultz: This is a unique inflection point for Starbucks; I think we've identified a very big opportunity to do something that really has not been done before. And that is the following: there are many, many companies, domestically and around the world, that have built a domestic national footprint around retail stores, just like Starbucks—the Gap, Costco, Wal-Mart, Coach, Zara. And there are many consumer-packaged-goods companies—Pepsi, Coke, Kellogg's, Campbell's. There hasn't been one company I can identify that has been able to build complementary channels of distribution by integrating the retail footprint and the ubiquitous channels of distribution—in our case, grocery stores and drug stores.

So the model is, Starbucks can seed and introduce new products and new brands inside our stores. We introduced VIA instant coffee in our stores. Instant coffee is a \$24 billion global category that has not had any innovation in over 50 years. And no growth. If we took VIA and we put it into grocery stores and it sat on a shelf, it would have died. But we can integrate VIA into the emotional connection we have with our customers in our stores. We did that for six to eight months and succeeded well beyond expectations in our stores. And as a result of that, we had a very easy time convincing the trade, because they wanted it so badly.

We can draft off of our stores into ubiquitous channels of distribution and then integrate that into the capability and the discipline we have around social and digital media. And this is not a pipe dream. This will happen in 2011. Right now, one out of every five transactions in our stores happens off the Starbucks card. And it's growing rapidly. Sometime in 2011, not only are you going to be rewarded for buying something at a Starbucks store, but buying Starbucks-branded products in a grocery store is also going to give you a reward off your Starbucks card. So we're going to integrate the reward system, in a way that has never been done before, between our retail stores and the wholesale channel.

The Quarterly: *Let's shift gears and talk about Starbucks' potential in emerging markets.*

Howard Schultz: The big opportunity, in terms of total stores, is what's happening in China; we've got 800 stores in greater China, 400 in the mainland. When all is said and done, we'll have thousands. We're highly profitable there. We've been there 12 years, and I would say that the hard work—in terms of building the foundation to get access to real estate, design stores, and operate them—is well in place.

We started out, like most Western brands, going to the two major cities, Shanghai and Beijing. In the last couple of years, it is stunning to see what we've been able to do in secondary and tertiary markets—these markets have five to ten million people in them. This past month, we opened up in two cities that people never heard of. One is Fuzhou, which has a population north of five million people. In a rainstorm, people were lined up in the morning waiting for the Starbucks door to open.

I was in China last month, and a government official told me there are now 140 cities in China with a population north of a million people. We don't have a rollout plan for 140 of those cities, but we strongly believe that the discipline and the process are in place for us to execute a very big growth plan in China, learning from the mistakes we made in the US.

Every consumer brand imaginable is rushing to these emerging markets, with China being the number one. I wasn't around for the gold rush, but I suspect that's what it's like: everyone's just throwing stuff against the wall, hoping something's going to stick. We want to be very thoughtful and disciplined—not get carried away, not go to too many cities. I don't want to go so wide. I think success in China, for us, is making sure we go deep in these markets before we spread out to so many markets around the country. It can be seductive; we've got to be very disciplined.

The Quarterly: *So how do you choose?*

Howard Schultz: There's a whole team, a real-estate team—that is, a local one—that is working with our people here in Seattle. As you might imagine, we have built, over the last 40 years, a very refined model in terms of demography and understanding where our stores should be located. And based on the success we've had in China over the last few years, we're now mapping those statistics and metrics in a way that gives us a very good understanding, with great predictability.

The Quarterly: *What other emerging markets strike you as particularly important?*

Howard Schultz: I just came back from India, and we will open up stores there, hopefully within the next 12 months. I think we're significantly understored in Brazil, where we've got 50 stores or so—with a very big upside. We're not in Vietnam yet; we're looking at Vietnam with a close eye. If we're lucky, maybe we'll get there by 2012.

The Quarterly: *How do you think about prioritizing growth opportunities in those countries?*

Howard Schultz: It's clear that the number-one growth opportunity is China. We believe that we can build a major business in India, but we're not there yet. So our international team created a growth plan for the next three years in terms of the number of stores, the number of markets. The US team has done the same thing on a parallel track, and then we've laid onto that the investment that we're making currently in building a significant capability and business model around CPG,² which is what I described earlier.

The Quarterly: *You said in your book that you're particularly cognizant of not wanting the same things to happen in China that happened in the United States. What are you doing to guard against that?*

Howard Schultz: All of the learning in the last two and a half years of the transformation is now being layered onto every international market in terms of how we operate the stores and how we enhance the customer experience. Now, with regard to China, given the fact that it is a big opportunity, we are providing the China team with resources that, perhaps, other markets are not getting—senior people who are managing big businesses at Starbucks are going over to China to ensure that the China team has the benefit of all the things that we've learned, as well as the benefit of the mistakes that we've made. I'm spending a disproportionate amount of time there myself; maybe it's my own paranoia.

²Consumer packaged goods.

What we want to do as a company is put our feet in the shoes of our customers. What does that mean, especially in China? It means that not everything from Starbucks in China should be invented in Starbucks in Seattle. Now, the Chinese customer, like many customers around the world, does not want a watered-down Starbucks. But we want to be highly respectful of the cultural differences in every market, especially China, and appeal to the Chinese customer. So as an example, the food for the Chinese stores is predominantly designed for the Chinese palate.

Now, this is not a company that did these kinds of things in the past. We were fighting a war here between the people in Seattle who want a blueberry muffin and the people in China who say, “You know what, I think black sesame is probably an ingredient that they would rather have than blueberry.” And I would say that goes back to the hubris of the past, when we thought, we’re going to change behavior. Well, no, we’re not going to change behavior. In fact, we’re going to appeal with great respect to local tastes. So we have a list of core products, in almost every country we’re now doing business in, that is right down the center to appeal to the local consumer.

What we’re trying to do is create a balance between this being a Starbucks store with all the trappings and, at the same time, a very deep level of sensitivity to local relevancy. That’s hard to do when you’re all over the world in 55 countries. The reason it’s working is that we’re decentralizing and, for the first time, trusting that the people in the marketplace know better than the people in Seattle.

The Quarterly: *What’s your biggest growth constraint?*

Howard Schultz: It’s not financing. We’re sitting on about \$2 billion in cash. And what I’ve said publicly to the Street is that this probably will be the first time in our history when we will be quite opportunistic about potential acquisitions.

Rather, it’s human capital. We want to attract world-class people who have values that are well aligned with the culture of the company. And we want to make sure that the growth of Starbucks in the future doesn’t in any way cover up the mistakes we’ve made in the past.

The Quarterly: *How worried are you that growth could become carcinogenic again?*

Howard Schultz: I’m not worried about that at all. I can’t count on one hand how many times the leadership team or the company has celebrated over the last 18 months. And the truth is, we’ve had a lot to celebrate. We’ve more than quadrupled the market value of the company. We had record revenue, record profit for the year, for the quarter.

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But we are actually turning over rocks and looking at the things that perhaps we didn’t get right and constantly, I think, beating ourselves up. If you walked into our Monday morning meeting, you would think this is a company that is still trying to transform itself. I would describe the team and I as spending as much time as we did then looking in the rear-view mirror—at the things we’ve just done to ensure that we’ve laid the right foundation and that the culture is preserved as we grow the company. It’s quite a different discipline and mentality than we had in the past.

There is a discipline of being very self-critical, with real quantitative metrics to study the investments that we’re making across the board, whatever they are—return on investment in stores, return on investment in advertising, return on investment in new-product introductions; looking at the entry cost of new markets in a different light; looking at the supply chain in a different way. This is a company that took \$700 million of costs out of its operations in the last two years. And we’re still looking for more. ○

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