



## Chapter Five

### Can a company fight the marketplace?

#### Starbucks

##### **(Chapter Excerpted)**

...Success itself has become a problem for Starbucks. The company is approaching ubiquity, expanding into the suburbs and even small towns. (Six stores are located within a 10-minute drive of my home in Bethesda.) Its omnipresence has become fodder for comedians. “A New Starbucks Opens in Restroom of Existing Starbucks,” read a headline in the satirical newspaper The Onion. Starbucks products are available on United Airlines, in Starwood, Hyatt and Marriott Hotels, in Barnes & Noble bookstores, in about 19,000 supermarkets, even, if you include the bottled drinks, at highway rest stops and in 7-11. Not surprisingly, many people regard Starbucks as just another soulless big chain. The most benign criticism of Starbucks is that no company so vast can

provide a special experience, let alone build relationships with customers that are more than transactional. Some Starbucks stores, in my experience, now deliver indifferent service in unkempt environments. These are fixable problems, though, and success on a global scale need not prevent a well-run company from building emotional ties to customers. If you doubt it, take a child to Disney World.

More worrisome are the risks posed to the Starbucks' brand by a ragtag army of critics. Campus activists, neighborhood preservationists and anti-globalization protestors have all gone after the company. (I once saw a bumper sticker in San Francisco that said 'Friends Don't Let Friends Go To Starbucks.') Much of the criticism is ill founded. In Manhattan, a character known as Rev. Billy of the "Church of Stop Shopping" has invaded stores and dumped Starbucks trash on the tables, accusing Starbucks of "corporate ruthlessness" and as it builds a monopoly to destroy "the mom & pop greasy spoons and bohemian coffee bars that make our neighborhoods unique." This is false, as it happens: While Starbucks has grown rapidly, the number of coffee bars operated by local owners and rival chains have grown even faster, according to the Specialty Coffee Association of America, an industry group. A group called the Organic Consumers Association, meanwhile, has called for a boycott of Starbucks because it serves milk from dairies using the genetically engineered bovine growth hormone called rBST. This is hardly a Starbucks' issue. Less than 5% of the nation's milk supply can be certified as hormone-free, and Starbucks' customers who ask for it can get hormone-free milk or, for that matter, soy milk. The antipathy towards Starbucks came home during the World Trade Organization meetings in Seattle in 1999 when black-masked anarchists denounced Starbucks and smashed windows in three downtown stores.

The Starbucks backlash distresses company executives. They have tried to build a better kind of company, and now they are being lumped in with all of Big Business. But they cannot claim that they didn't see it coming: their own market research found nearly a decade ago that the biggest threat to the Starbucks brand was "a growing belief among customers that the company was becoming corporate and predictable, inaccessible, or irrelevant." Schultz has long feared that rapid growth would make it difficult to sustain the company's values. "How do we grow big but maintain intimacy with our people?" he has said. "This is the toughest dilemma I face as the leader of Starbucks." Its coffee-buying practices have been brewing as an issue for a long time, too. In 1994, Chicago labor activists picketed stores, accusing the company of exploiting coffee growers in Guatemala. Perhaps because the charges were off the mark—Starbucks did not then and does not now own coffee farms, grow its own coffee or employ growers—the company dismissed them. The idea that a company could be held responsible for actions taken far up its supply chain was novel in the mid-1990s.

Besides, its executives said, Starbucks did care about coffee growers. The company had long demonstrated its concern by supporting educational, health, and social service projects in origin countries. Starbucks launched a partnership with CARE, for example, in 1991, and became one of the nonprofit's biggest corporate donors. Since 1998, Starbucks has worked closely with the nonprofit Conservation International to help preserve a "biodiversity hotspot" in Chiapas, Mexico. The company pays farmers there a premium for "shade-grown" coffee, which is cultivated by a traditional method that preserves tropical forests. (Under economic pressures, some growers cut down trees to boost production.) Most important, Starbucks has always paid top prices for coffee, often

twice as much as other buyers, so that it can obtain the highest quality beans. The specialty coffee business has been a boon to growers. “Philanthropy is important, but it’s a drop in the bucket compared to the impact of the higher prices we pay,” Smith told me. “Almost nobody else was paying those prices.” The Starbucks people saw themselves as part of the solution, not part of the problem. “When we get labeled, it’s pretty painful and it can pretty quickly make you angry,” Smith said. They felt maligned.

When the world coffee market collapsed in 1999, Starbucks became an even more inviting target for activists—although the company had nothing to do with the precipitous drop in coffee prices. Grown in about 70 tropical countries, coffee is the world’s second-most traded commodity, after oil, with a global export value of more than \$5 billion a year. Until 1989, coffee prices were set by an OPEC-like mechanism called the International Coffee Agreement, which was intended to stabilize third world economies and minimize discontent that could be exploited by leftists. When the Cold War ended, the U.S. withdrew its support for the cartel. After an oversupply of low-grade coffee from Vietnam flooded the market in the late 1990s, there was nothing to keep prices up. Many of the world’s 25 million growers were devastated as the price per pound for commodity-grade coffee fell below 50 cents, from a peak of nearly \$2. “Farmers who can’t make a living are abandoning their farms,” Peter Torrebiarte, Starbucks’ green coffee manager and a native of Guatemala, told me.

The Fair Trade movement—which would soon pose a problem for Starbucks -- arrived in the United States in 1999, just as the coffee crisis hit. The concept of Fair Trade requires a brief explanation: Beginning in the 1940s, churches in North America and Europe sought to provide relief to poor people in the so-called third world by buying

handicrafts and, later, commodities directly from the producers. To insure that products carrying the Fair Trade label do, in fact, benefit the poor, a global alliance of nonprofit groups established a system of independent, third party certification. To use the Fair Trade label—think of it as the politically correct equivalent of the Good Housekeeping Seal—companies must contract with one of the nonprofits that will then monitor its practices. (Currently, there are Fair Trade systems in place for tea, chocolate and bananas as well as coffee.) Coffee sold with the Fair Trade label in the United States must be purchased from democratic, worker-owned cooperatives at a price set by TransFair USA, the nonprofit certifying agency in this country. In 2003, the price was set at \$1.26 per pound for regular coffee and \$1.41 per pound for organic coffee—more than twice the price of commodity-grade coffee. Growers needed higher prices to sustain themselves.

The Fair Trade movement and its allies immediately targeted Starbucks. This had more to do with the company's visibility than with its coffee-buying practices. Starbucks buys only high-quality arabica coffee and it pays prices that are near the Fair Trade minimums. (In 2002, the company paid an average price of \$1.20 per pound.) Its purchases represent only about one percent of the world's bean—most coffee is still sold in supermarkets, or fast-food outlets, or gas stations--so a change in its practices would have only a limited impact on growers. By contrast, the coffee divisions of four big multinational corporations—Nestle, Kraft, Procter & Gamble and Sara Lee—buy about half of the world's coffee and pay far less per pound, probably an amount close to the commodity-grade price of about 40 to 50 cents a pound. (They don't disclose their costs.) But how do you go after companies that don't have stores and sell coffee under many different brands—Chock Full o' Nuts, Folger's, Maxwell House, Nescafe and

Yuban? Starbucks is not just a convenient target, but also a tempting one because of the contrast that can be drawn between \$3 lattes and impoverished farm workers. It's a false contrast, of course—in theory, at least, higher prices for coffee make possible higher prices for the growers. In any event, a vocal group of activists organized by a human rights group called Global Exchange showed up at Starbucks' annual shareholders meeting in March 2000, demanding that the company sell Fair Trade coffee. Protests were planned. Campuses were mobilized. An open letter to Schultz accused Starbucks of exploiting growers. "The farmers who make you rich earn poverty wages," it said. "Sweatshops occur not only in the factory but in the field."

Surprisingly, Starbucks was unprepared for the onslaught. "We got blind sided," Smith said. Starbucks executives naively felt that their good intentions and track record would shield them from attack. "The advocacy groups, quite frankly, they either didn't get or didn't want to get the model," Smith said. "They wanted somebody they could bang on." But the activists saw Starbucks as just another big business. "They have a basic distrust, or cynicism," Smith said. Nevertheless, Starbucks choose to make peace rather than resist the Fair Trade pressures. The people at Starbucks say they share the goal of the Fair Trade movement—they, too, want to enable coffee growers to make a living and stay in business—and so they hastily negotiated a licensing agreement with TransFair USA. Days before the protests were to begin, Starbucks announced its plans to launch a line of Fair Trade certified coffee.

Officially, Starbucks endorses the concept of Fair Trade. In its 2002 Corporate Social Responsibility report, Starbucks said that it bought 1.1 million pounds of Fair Trade Certified Coffee, representing about 1% of its total purchases. That was nearly

twice what it bought in FY2001. Privately, though, Starbucks executives have mixed feelings about Fair Trade. They did not like being put on the defensive. “The emphasis that the Fair Trade people have placed on specialty coffee is, by and large, misdirected,” Smith said. The global coffee giants buy more coffee, and at cheaper prices, he noted. Starbucks also says that Fair Trade is a limited response to the coffee crisis, in part because only coffee from worker-owned cooperatives can be certified as Fair Trade. Most coffee, including most of the high-quality coffee Starbucks needs, comes from plantations, wholesalers or small farmers. Besides that, the very idea of Fair Trade poses a threat to Starbucks: The company does not want to promote the “brand” of Fair Trade, if only because it implies that the rest of Starbucks’ coffee is somehow tainted. It’s not hard to imagine how Starbucks executives feel when they see Medea Benjamin, the executive director of Global Exchange, quoted in a Time magazine article about Starbucks saying: “Coffee without the Fair Trade seal is very likely sweatshop coffee.” She’s right about most coffee sold in the U.S., but not about the coffee sold at Starbucks.

Global Exchange wants Starbucks to do more to promote Fair Trade. It is asking the company to buy, brew and sell more Fair Trade coffee and to offer a decaf Fair Trade blend. By contrast, Paul Rice, director of TransFair USA, the certifying organization, told the National Catholic Reporter: “I think Starbucks gets a bad rap. It’s a mistake to target Starbucks because they are not doing enough, and not target Kraft or Nestle or Procter & Gamble who aren’t doing anything and won’t even return my calls.” Recently, P&G, through its Millstone brand, and Kraft, whose coffee brands include Maxwell House and Jacobs, made major commitments to buy fair trade coffee and support sustainable coffee

production—a big breakthrough for the activists, and for socially responsible investors who brought pressure to bear on Kraft and P&G.

So how will Starbucks deal with the coffee crisis—and with its critics? It will not embrace the Fair Trade model. Nor will it seek to exploit the depressed coffee market. Instead, true to form, Starbucks has set out to create a market of its own. In 2001, Starbucks announced a set of coffee-sourcing guidelines, developed with the help of Conservation International, that will revamp the way the company buys coffee. Under the guidelines, Starbucks will pay higher prices to farmers who meet a long list of social, environmental, economic and quality standards. The guidelines are complicated, but their purpose is simple: to enable growers to earn a decent living, to conserve the tropical environment and to provide Starbucks with a reliable supply of quality coffee.

This is not the approach most companies take when the price for a commodity they need begins to fall. As Smith said: “We could take a short-term view and say, OK, this year we’re going to jump right in. There are low prices out there. Let’s optimize. Then, the next thing you know, I’m going to lose a bunch of my farms...If we allow that to happen, it will threaten, on a long-term basis, our supply.” Starbucks expects to need lots more coffee in the years ahead. “We’re at 7,000 stores now,” Smith said. “We’re talking about a minimum of 25,000 on a global scale.” Coffee czar Dub Hay put in simply: “The growers are our future.”

Many coffee growers have embraced the guidelines, according to the company. Two years after they were introduced, Starbucks had received more than 160 applications from suppliers in 14 countries in Latin America, Asia and Africa. (Some came from big groups of farmers.) Those growers who earn the maximum rating under the guidelines



will be paid 10 cents extra per pound for their coffee and be given “preferred supplier” status, meaning that they will be first in line to sell more coffee to Starbucks when it is needed. “When we’re growing at 30% a year, they stand to gain,” Hay said. In return, the growers will have to obey local labor laws and international conventions governing workers’ wages, human rights, health and safety. They will have to employ growing and processing methods that help conserve soil, water and biological diversity. They will also have to produce high quality coffee, of course. “They’re graded on a point system,” Hay said, “and they are going to be audited and verified.” I asked him if farmers in the program might feel micromanaged by Starbucks. “This was built with grower input,” he replied. “We’re all in this together.” Most growers welcome the arrival of Starbucks, according to the company and its nonprofit partners. Said Dub: “This is the only place in my buying career when I’ve looked someone in the eye and said, ‘Are we paying you enough?’ “

Convincing the activists that Starbucks is doing the right thing will be difficult. Starbucks says that its practices are more comprehensive than the Fair Trade standards, and that third parties will audit them. But it also concedes that the vast majority of the coffee it sells will not carry the Fair Trade brand. Today, that’s a non-issue with most consumers. But if Fair Trade wins a bigger following, Starbucks’ go-it-alone approach will appear suspect. “The question they have to ask is, ‘will consumers accept corporations who audit themselves?’ said Haven Bourke of TransFair USA. “In these days of post-Enron and post-Worldcom, we think the independent third-party guarantee of credibility is very important.” Smith acknowledges the risk. “From a brand standpoint, Fair Trade is a great name,” he said. “I give them a lot of credit for it, and I don’t

disagree with what they are trying to do.” But, he said, the company’s standards are superior, and they make more sense for Starbucks and for the growers. Whether Starbucks can sell its story in the marketplace of ideas is an open question...

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