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Starbucks Coffee Company*

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

Fair trade began after World War II as religiously–affiliated, non-profit organizations purchased handmade products for resale from European producers. During the 1970s and 1980s, the concept evolved further into buying crafts from low-income, third-world producers at a "fair" price and selling those products in Western markets.[1] Fair trade was an economic model based on fair labor compensation and mutual respect between producers and consumers. By the late 1990s, the fair trade movement had gained a foothold in the United States, and in early 1999, TransFair USA, a third party certification agency, launched its Fair Trade Certified coffee label. During that summer, Global Exchange began a campaign to educate consumers and the media about labor conditions in the coffee industry, focusing on getting the message out to specialty coffee consumers. Although the activists were successful in educating pockets of consumers, they knew their effectiveness was limited without directing blame for the farmers' woes. Global Exchange decided to take an anti-corporation stance and focused their attention on the most visible brand in specialty coffee: Starbucks.

Starbucks Coffee Company grew from a small, regional business into the undisputed leader in the specialty coffee industry by buying only the best quality coffee and providing an unmatched store experience. The company's coffee buyers had built long-standing relationships with farmers and believed it paid the highest prices in the industry for top-quality beans. Adopting the fair trade model would cause serious concerns for Starbucks, as fair trade paid a floor price of $1.26 regardless of bean quality. Starbucks coffee buyers had

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to admit that while they paid high prices, they didn't always know whether farmers got their fair share. It was virtually impossible to track the flow of money from the importers and exporters back through the supply chain to the individual farmer. By dealing only with cooperatives, TransFair USA by-passed most of these problems and added value by producing financial transparency. Yet being a socially responsive corporation was a key tenet of Starbucks' mission statement. The intent of fair trade advocates to raise small farmer incomes was consistent with the company's values. Treating partners (Starbucks employees), customers, and suppliers with dignity and respect was essential to the company. In fact, it came as a shock to many at Starbucks that activist groups were criticizing their company for unfair practices. As he watched the sky darken outside his window, Orin Smith asked himself just how socially responsive his company could be without affecting the fundamental business practices that had been the foundation of its great success.

History of Starbucks

In 1971, three atypical businessmen founded Starbucks Coffee, Tea and Spice in Seattle, Washington. Gordon Bowker, Jerry Baldwin, and Zev Siegl shared many interests, but their main reason for starting the company was their love of coffee and tea and their desire for Seattle to have access to the best of it.[2] While attending school in San Francisco, Baldwin discovered Peet's Coffee in Berkeley and fell in love with the rich, dark arabica whole bean coffee. Baldwin introduced his roommate, Gordon Bowker, to Peet's Coffee, and after the two moved to Seattle they continued to order Peet's by mail. Bowker stumbled upon another great store in Vancouver, Canada and would often make the 3-hour trip there from Seattle to buy Murchie's coffee. While traveling back from one of these trips, Bowker had the idea of opening up a coffee store in Seattle. Baldwin loved the idea as did Bowker's neighbor Zev Siegl, and Starbucks was born.[3]

The company grew slowly and by 1981 had a roasting plant and four retail stores that sold whole bean coffee in Seattle. That year, Howard Schultz, who was working for a Swedish houseware company in New York, became curious about why Starbucks was buying large quantities of a certain drip coffeemaker. Schultz flew out to Seattle and met with Baldwin and Bowker to learn more about the company. Starbucks captivated Schultz, and by 1982 he had convinced Baldwin, who was running the company, to hire him in marketing. In 1983, Starbucks sent Schultz to Italy. While there, he dreamed of re-creating the magic and romance behind the Italian coffee bar culture by serving espresso by the cup.[4] It took Schultz a year to convince Baldwin and Bowker to serve espresso drinks, but he was allowed to test the idea when Starbucks opened its sixth store in downtown Seattle. The concept was a hit and within 2 months that store was serving 800 customers a day—three times as many as their best selling whole bean locations.[5]

Schultz urged Baldwin to expand the idea to other stores but Baldwin felt strongly that selling beverages distracted from the core business of selling top quality, whole bean coffee. With financial backing from Starbucks, Schultz left the company and opened his own coffee bar called Il Giornale in 1985.[6] Before its opening, Dave Olsen, owner of the funky Café Allegro near the University of Washington, called Schultz and expressed an interest in joining forces. As it turned out, the two were a great match: while Schultz focused outward to build the company, Olsen understood the operational realities of running a retail café. As the "coffee conscience of the company," Olsen ensured that Il Giornale served only the best quality coffee using a custom-made espresso roast from Starbucks beans.[7] In 1983, shortly before Schultz left Starbucks, Baldwin and Bowker had bought Peet's Coffee, and by 1987, made the decision to sell Starbucks' six retail stores, roasting plant, and corporate name so that Bowker could take a break from the coffee business and Baldwin could focus his time on Peet's. Although Il Giornale only had three stores, Schultz and a group of local investors bought Starbucks for $3.7 million and changed Il Giornale's name to Starbucks Coffee Company.

The next few years brought tremendous changes to Starbucks. Using the original Il Giornale business plan, Schultz promised investors they would open 125 Starbucks stores in the next five years. Starting from a base of 17 stores in 1987, the company quickly expanded into Chicago, Vancouver, and Portland. During this initial period, Schultz hired seasoned executives to help with the growth of the company. In 1989, Schultz brought in Howard Behar who was familiar with opening and running several retail stores at once, and the following year Orin Smith joined Starbucks as their Chief Financial and Operations Officer. Both Smith and Behar were 10 years senior to Schultz and brought with them seasoned experience to help build the company's infrastructure. This executive management team, fondly called "H2O," worked tightly together to grow the business. By 1991, Starbucks had ventured into the mail-order catalogue business, licensed airport stores, expanded into California, and had just over 100 retail stores. The company went public in 1992.

After the initial public offering, Starbucks continued to grow at a dizzying pace both in terms of store development and new enterprises. Within five years, the number of Starbucks stores grew tenfold, with locations in the US, Japan, and Singapore.[8] In addition to opening and licensing retail locations, Starbucks initiated several successful product and brand extensions, including offering coffee on United Airlines flights, selling premium teas through its wholly owned subsidiary Tazo Tea Company, developing a ~~cold~~ bottled version of its popular Frappuccino blended beverage with PepsiCo and premium coffee ice-cream with Dreyers, and distributing whole bean and ground coffee at supermarkets through an agreement with Kraft. Starbucks even sold jazz CDs in its retail stores. In 1999, Schultz made Smith, who had become President and COO in 1994, the CEO but remained active in the company as the Chairman and Chief Global Strategist. By 2002, 85% of Starbucks' revenue came from company-operated retail stores and the remainder from licensed stores, key partnerships and specialty operations such as foodservice accounts and mail-order catalogue sales.[9] In 2000, Interbrand, a brand-valuation firm, ranked Starbucks 88th in its survey of the 100 Best Global Brands. In the same survey, Starbucks also ranked as the world's fastest-growing brand.[10] What intrigued many was that Starbucks grew its brand into a household name not through advertising, but by word-of-mouth. In fact, up to 1996, Starbucks had spent a total of only $10 million on advertising.[11] By 2002, the once small, regional roaster claimed over $3.3 billion in annual revenues and more than 5,800 locations in 30 countries serving approximately 20 million customers a week.[12] (See Exhibit 1 for Starbucks Financial Statements)

Starbucks Culture

In 1990, Starbucks' senior executive team drafted a mission statement laying out the guiding principles behind the company. The team hoped that the principles included in this mission statement would help partners gauge the appropriateness of their decisions and actions. As Orin Smith explained, "Those guidelines are part of our culture and we try to live by them every day."[13] After drafting the mission statement, the executive team asked all Starbucks partners to review and comment on the document. Based on their feedback, the final statement (Please see Exhibit 2), put "people first and profits last."[14] In fact, the number one guiding principle in Starbucks' mission statement was to "provide a great work environment and treat each other with respect and dignity."[15]

Going forward, Starbucks did three things to keep the mission and guiding principles alive. First, it provided all new partners with a copy of the mission statement and comment cards during orientation. Second, when making presentations, Starbucks leadership continually related decisions back to the appropriate guiding principle or principles they supported. And third, the company developed a "Mission Review" system through which any partner could comment on a decision or action relative to its consistency with one of the six principles. The partner most knowledgeable on the comment had to respond directly to such a submission within 2 weeks or, if the comment was anonymous, the response appeared in a monthly report.[16] As a result of this continual emphasis, the guiding principles and their underlying values had become the cornerstones of a very strong culture.

After buying Starbucks, Howard Schultz had worked to develop a benefits program that would attract top people who were eager to work for the company and committed to excellence. One of Schultz's key philosophies was to "treat people like family, and they will be loyal and give their all." Accordingly, Starbucks paid more than the going wage in the restaurant and retail industries, granted stock options to both full and part-time partners in proportion to their level of base pay, and offered health benefits for both full and part-time partners.[17] In return, Starbucks had a partner turnover rate of 60% compared to the restaurant industry average of 200%.[18] Furthermore, 82% of the partners rated being "very satisfied" and 15% as "satisfied" with their jobs when asked by outside audit agencies. While such a high satisfaction rate could be found in many small, privately-held companies, it was virtually unheard of for a large, publicly traded corporation of over 55,000 employees.[19] All of this had fostered a strong culture that employed a predominately young and educated workforce who were extremely proud to work for Starbucks. Their pride came from working for a very visible and successful company that tried to act in accordance with the values they shared. According to Smith, "It's extremely valuable to have people proud to work for Starbucks and we make decisions that are consistent with what our partners expect of us."[20]

Being a Responsible Corporation

Just as treating partners well was one of the pillars of Starbucks' culture, so was contributing positively to the communities it served and to the environment.[21] Starbucks had made this commitment not only because it was the right thing to do, but also because its workforce was aware and concerned with global environmental and poverty issues. In addition to sustaining and growing its business, Starbucks supported causes "in both the communities where Starbucks stores were located and the countries where Starbucks coffee was grown."[22]

Contributing to Communities: Starbucks firmly believed that when it opened a store, the company added immediate value to that community because the store "becomes an instant gathering spot, a Third Place that draws people together."[23] Additionally, store managers were granted discretion to donate to local causes and provide coffee for local fund-raisers. One Seattle store donated more than $500,000 to Zion Preparatory Academy, an African-American school for inner-city youth.[24] In 1998 Starbucks and Erwin "Magic" Johnson's company, Johnson Development Corporation, formed a joint partnership and created the Urban Coffee Opportunities. Subsequently, 28 stores opened in urban communities, providing new employment and revitalization opportunities in several US cities.[25]

Howard Schultz personally believed that literacy had the power to change lives and foster hope for young children who lived in underserved neighborhoods. Accordingly, Schultz used the advance and on-going royalties from his book, *Pour Your Heart Into It*, to create the Starbucks Foundation, which provided "opportunity grants" to nonprofit literacy groups, sponsored young writers programs, and partnered with Jumpstart, an organization helping Headstart children. While it was completely separate from the company, Starbucks made an annual donation to the foundation.[26]

Contributing to Producing Countries: In 1991, Starbucks began contributing to CARE, a worldwide relief and development foundation, as a way to give back to coffee-origin countries. By 1995, Starbucks was CARE's largest corporate donor pledging more than $100,000 a year and specifying that its support go to coffee-producing countries.[27] The company's donations helped with projects like clean-water systems, health and sanitation training, and literacy efforts.[28] Over the years Starbucks has contributed more than $1.8 million to CARE.[29]

In 1998 Starbucks partnered with Conservation International (CI), a non-profit organization than helped promote biodiversity in coffee-growing regions, to support producers of shade-grown coffee. The coffee came from cooperatives in Chiapas, Mexico and was introduced as a limited edition in 1999. The cooperatives' land bordered the El Triunfo Biosphere Reserve, an area designated by CI as one of the 25 "hot spots" that were home to over half of the world's known plants and animals.[30] Since 1999, Starbucks had funded seasonal promotions of the coffee every year, with the hope of adding it to its lineup of year-round offerings. The results of the partnership had proven positive for both the environment and the Mexican farmers. Shade acreage increased by 220% while farmers received a price premium of 65% above the market price and increased exports by 50%. Since the beginning of the partnership Starbucks made loan guarantees that helped provide over $750,000 in loans to farmers.[31] This financial support enabled these farmers to nearly double their income.

In 1992 Starbucks developed an environmental mission statement to articulate more clearly how the company interacted with its environment, eventually creating an Environmental

Affairs team tasked with developing environmentally responsible policies and minimizing the company's "footprint."[32] Additionally, Starbucks was active in using environmental purchasing guidelines, reducing waste through recycling and energy conservation, and continually educating partners through the company's "Green Team" initiatives. In 1994, Starbucks hired Sue Mecklenburg as the first director of environmental affairs.

Although Starbucks supported responsible business practices virtually since its inception, as the company had grown, so had the importance of defending its image. It was Mecklenburg who developed the idea of using paper sleeves instead of double cupping.[33] At the end of 1999, Starbucks created a Corporate Social Responsibility department, and Dave Olsen was named the department's first Senior Vice President. According to Sue Mecklenburg, "Dave really is the heart and soul of the company and is acknowledged by others as a leader. By having Dave be the first Corporate Responsibility SVP, the department had instant credibility within the company."[34] Between 1994 and 2001, Starbucks' CSR department had grown from only one person to fourteen.

The Coffee Industry

Coffee, in all forms, was an $80 billion industry by the late 1990s.[35] The largest consuming regions were the European Union (35%), the United States (25%), and Japan (9%).[36] The industry could be broken into two main categories on the consumption side: mass-marketed and specialty coffee. The four largest companies and their brands such as Procter & Gamble (Folgers), Philip Morris (Maxwell House), Sara Lee (Hills Brothers) and Nestlé (Taster's Choice), operated almost exclusively in the mass-marketed segment. These companies imported more than 43% of the world's green coffee, and their products accounted for 35% of world consumption.[37] Due to their size and market reach, these companies had a large impact on coffee quality and consumption patterns. Starbucks, on the other hand, counted among the specialty retailers.

Although several coffee species exist, only two make up the majority of worldwide coffee consumption. They differ greatly in taste, caffeine content, disease resistance, and cultivation conditions. Coffea arabica, commonly referred to as arabica beans, were the oldest beans used in coffee production and accounted for 65% of the world's coffee supply[38]; 80% of these beans came from Central and Latin America.[39] Arabicas were susceptible to poor soils and diseases and thus required great care in growing. Coffee connoisseurs consider arabicas to be tastier than their counterpart, coffea canephora, also known as robusta beans. These beans evolved around 1850 but only entered the commercial market after World War II. Robusta beans, typically grown in West Africa and Southeast Asia, were easier to grow because they tolerated warmer and more humid climates and a wider range of soil conditions. Experts claimed that although these beans contained more caffeine, robustas were inferior in flavor because of their distinct bitterness. Since robustas were easier to grow and not nearly as tasty, the beans tended to command a much lower price on the market. As a result, robusta beans were primarily used in the instant and mass-produced coffee sold in large supermarket stores. Conversely, premium "washed" arabica beans that went into fine specialty coffees, could attain up to a 30% premium to robustas.[40]

The Specialty Coffee Industry

Between 1962 and 1974, coffee consumption in the United States declined from a peak of 3.1 cups a day to 2.2 cups.[41] One of the main reasons for this decline was the quality of coffee the large roasters were using to make up their blends. Starting in the mid-1950s, American roasters thought the only way to differentiate their product was on price, and they focused on gaining market share through the use of promotions and coupons. As a way to stay competitive, roasters began to include the cheaper robusta beans into their blends to decrease costs.[42] This trend continued throughout the 1960s and 1970s. However, in 1975 a severe frost hit Brazil and green coffee prices soared and remained high for over two years. As a result, the difference in cost between supermarket blends and specialty beans narrowed significantly, while the disparity in quality remained very high.[43] For just a little bit more money, consumers could not only buy coffee that actually tasted good, but also shop in a fragrant store and learn about all the different bean types from knowledgeable roasters. By 1980, several specialty roasters had built up a strong presence in the big cities on the East and West coasts. These roasters created their own trade group called the Specialty Coffee Association of America (SCAA) and quickly grew in numbers. By 1985, specialty coffee accounted for 5% of coffee retail sales and new roasters were opening up shops every week.[44]

By the 1990s, specialty coffee in the United States had become mainstream. Although overall coffee demand grew by only 1% in the US during the 1990s, this was not the case for specialty coffee.[45] From the mid 1980s until the late 1990s, coffee imported by specialty roasters grew from 1 million to over 2.7 million bags.[46] By 1999, specialty coffee accounted for more than 22% of coffee volume and approximately 37% of total US coffee sales. Beverage retailers were the fastest growing distribution channel in the specialty industry as witnessed by the number of people who claimed they drank specialty drinks. In 1998, 108 million Americans professed to drinking espressos, cappuccinos, lattes or iced/cold coffees, up from 80 million in 1997.[47] Furthermore, specialty coffee accounted for almost 20% of US home consumption.[48]

In response to this trend, during the mid-1990s many of the large coffee manufacturers acquired small roasters as a way to participate in the specialty coffee boom. For example, P&G's purchase of Millstone and Nestlé's purchase of Sark's Gourmet Coffee were executed as an attempt to maintain market share.[49] Although American consumers were not drinking more coffee, over the years, they had shifted their consumption patterns to drink better and more expensive beans.

The Economics of Coffee

After oil, coffee is the second most traded commodity on worldwide markets. Coffee is grown in more than 80 tropical and subtropical countries, employs an estimated 20 million rural farmers, and is the principal source of foreign exchange in many countries.[50] In 2001, coffee farmers and plantations produced 15.5 billion pounds of coffee while the world market only bought 13 billion pounds. Overproduction was not unusual in the coffee industry and was one of the major reasons why historically prices have traveled a boom-to-bust cycle.

From Bean to Export

Coffee beans begin at the farm on coffee trees. After trees are planted, it takes between one and three years for the trees to bear coffee "cherries," which typically contain two beans. Each tree produces 2,000 to 4,000 beans a year—approximately one pound of roasted coffee. However, yields alternate with a good crop one year and a poor crop the next.

Farm sizes range from 5 acres (traditional farms) to large plantations covering thousands of acres. Farming and harvesting methods differ greatly between traditional and large coffee farms. Traditional farms, called fincas in Latin America, usually have many non-coffee trees that shade the coffee plants from the glaring tropical sun. These farms are integrated agricultural systems that provide additional crops, protection from soil erosion, and homes to insects that act as natural pest control. Farmers on these smaller plots handpick cherries when it's time to harvest the trees. In contrast, large coffee plantations, fazendas (estates) in Brazil, use little to no shade, plant trees more densely in rows, and harvest the cherries mechanically.

Between 50 and 70% of the global coffee supply came from small-scale farms by 2001.[51] These small producers usually did not own the beneficios (mills) that were used to process the product from cherry to bean. While some did operate as part of a cooperative that collectively owned the mills, not all small-scale farmers had this as an option. Often, mills were owned and operated by the large farms and consequently, small farmers had little leverage when negotiating prices with these much larger owners. Coffee must be processed, and it was common for small farmers to accept a considerably lower price to be able to get their coffee to market. Often, these small producers had difficulties financing their operations throughout the year and would sell their crop to middlemen known as "coyotes" prior to harvest to receive a cash advance. These middlemen provided small farmers with credit at high interest rates in exchange for bringing their beans to market. The small-scale farmer was often caught in a perpetual cycle of poverty: small production levels limited their access to cash which, in turn, hindered the potential for increasing output. For many producing countries, coffee was tightly connected to the social and political power structures that had existed for hundreds of years.[52]

From Export to Cup

The coffee export process varied greatly depending on origin country and buyer. (Please see Exhibit 3.) In some countries, beans were exported through government coffee boards while other countries used private exporters only. After they were shipped to the import country, coffee beans were visually inspected and test-tasted for quality through a process called "cupping." After passing inspection, coffee was stored in warehouses until it was shipped to roasters. Large roasters often had their own coffee buyers and procured green beans directly from producers. Large roasters also stockpiled green coffee at the import warehouses to help decrease their exposure to market conditions. Conversely, smaller roasters bought coffee from independent brokers and importers who may have amassed beans at warehouses and thus were exposed to a much larger risk of price fluctuations.

After roasters buy green coffee, the beans are shipped to roasting facilities where the beans are roasted until they receive their characteristic color and aroma and then cooled. Once the beans are cooled, roasters blend beans from different countries to balance the flavors and strengths. This process is essential because it allows for a consistent flavor even if supplies vary due to prices and availability. Roasters then package, market, and distribute coffee through a variety of methods. The largest roasters grind and vacuum-pack coffee in packed bricks or cans and distribute their product through wholesale channels. These roasters supply coffee for restaurants, airlines, and hotels in addition to selling directly to consumers through supermarket channels. Specialty coffee, in contrast, is roasted and packaged in a manner to guarantee quality and freshness. It is sold in both whole bean and ground forms through wholesale and retail channels.

Coffee prices are set on the New York Coffee and Sugar Exchange and are known in the industry as the "C" market rate. Roasters will pay a price differential for beans with certain specifications like origin country and processing method well above the "C" price.[53] Starbucks Coffee Company did not buy their coffee off the "C" market. Coffee is no different than other commodity products in that its prices depend greatly on supply and demand. When great harvests increase supply and cause overproduction, for example, the market reacts by decreasing the price, forcing some farmers out of business. As supply and demand once again reach equilibrium, weather conditions can change, causing supply to contract. For example, if a rare frost in Brazil destroys a coffee harvest, prices soar. These high prices encourage farmers to enter back into the market. However, by the time those new trees are ready to bear fruit, supply and demand have reached equilibrium and there is an overproduction of beans once again. Roasters and importers will often hedge their positions against these potential outcomes by buying coffee futures, and this price speculation can actually add to the great volatility on the coffee market.

World coffee production fluctuated mainly on the Brazilian harvest as that country accounted for 30% of the market by 2001.[54] Historically, Columbia and Brazil had been the largest arabica producers while Indonesia and Cote D'Ivoire produced the most robusta beans. However, the 1990s brought several changes to world production and coffee prices. First, in 1989 the International Coffee Agreement (ICA) was not renewed. For years the ICA controlled supply and prices by setting quotas for producing countries. Second, coffee production increased by 15% between 1990 and 2000, twice the rate of consumption.[55] Third, Brazil became the second-largest producer of robusta beans after Indonesia.[56] And lastly, Vietnam became the third largest coffee producer increasing production from 13.2 million pounds to more than a billion by 2000.[57] Although Vietnam did produce some arabica beans, 92% of its output consisted of robusta beans. Consequently, a flood of robusta beans had sent coffee prices to the lowest levels they had experienced in over 50 years.[58] Unless Brazil were to experience another severe frost, oversupply was expected to continue for the next 5 years, which would lower coffee prices even further.[59]

Sustainable Coffee & the Specialty Coffee Industry

Over the years, critics had pointed out that the coffee industry did not always protect the environment or treat the laborers who harvest the beans fairly. On the environmental side, coffee farmers had been encouraged by foreign aid to "modernize" their lands, and, accordingly, had stripped shade trees and begun using chemical pesticides and fertilizers. These practices had created problems ranging from water contamination to deforestation. From an economic standpoint, farmers and laborers often made less than $3 a day during the harvest season, working in some of the harshest conditions. In the mid 1990s, several coffee industry players, consumers, and activists had underscored the role coffee plays in both the environmental and economic status of producing countries and had voiced a desire to change the system.[60] Further, the chronic oversupply of coffee meant that, sooner or later, some farmers would go out of business. Faced with this prospect, small farmers across the world were abandoning their coffee farms in the hopes of finding employment elsewhere. For the specialty coffee industry all of this became increasingly worrisome, as it implied that there would soon be less high-quality arabica beans available to them. Because the specialty coffee industry understood that its future was closely linked to coffee farmers and the environment, three categories of coffees emerged that aimed to reduce the negative environmental and social externalities of coffee:

- *Organic coffees* were produced without using synthetic chemicals and with farming methods that preserved the land. These coffees were introduced during the 1980s, but many in the specialty industry were not enthusiastic about their quality. Nevertheless, organic coffee improved tremendously and by the late 1990s accounted for approximately 3% of the specialty market.[61] However, the certification process was long and costly: farms were inspected for three consecutive years and the certification process could be prohibitively expensive. Many farmers used organic farming methods, but due to the time and costs associated with certification, their beans were not certified and could not be sold as organic.

- *Shade coffees* were grown in shaded forests that provided an important habitat for indigenous wildlife and migratory birds. Research on ecological damage from "modernized" coffee farms started in the late 1980s.[62] Biologists from the Smithsonian Migratory Bird Center found more bird species on shade-coffee farms than anywhere else except tropical forests. Without the shade trees, however, bird diversity dropped 94 to 97%.[63] In contrast to organic coffee, there were many different sets of criteria that were applied by several certifying agencies to designate coffee as shade grown.[64] Consequently, the shade-grown movement was fragmented and accounted for only approximately 1% of the specialty market.[65]

- *Fair trade coffees* were coffees that were purchased directly from cooperatives of small farmers at a guaranteed floor price. Unlike shade and organic coffees, fair trade coffee focused on the worker's economic sustainability. Fair trade coffee attempted to cut out or limit the middlemen and provided much-needed credit to small farmers so that they could end their poverty cycle. Licensing organizations in individual importing countries certified fair trade coffee from farmers listed on the Fair Trade Registry. Consequently, there were a host of different certifying agencies, and fair trade coffee accounted for different market share in each country.[66]

While each of these varieties of coffee had its own set of criteria, applied by different certifying agencies, the categories often overlapped. This caused confusion for both coffee industry players and consumers.[67] Without clear standards, articulating this differentiation to consumers had been difficult for coffee retailers. Additionally, if consumers did not know which terminology to trust, this could ultimately erode the certification and premium price paid for sustainable coffee.[68] The specialty coffee industry was aware of this confusion, and according to a survey in 2001, 66% said they would like to develop a "super seal" that would encompass most, but not all, of the criteria for sustainable coffees.[69] Nevertheless, the three categories accounted for $188 million out of the $18.5 billion US retail market by 2001.[70]

Fair Trade Coffee

The 1980s was a turbulent decade for several Central American countries. Civil unrest in El Salvador, Guatemala, and Nicaragua eventually bled into the coffee economies of these countries, and both Nicaragua and El Salvador eventually nationalized coffee exports.[71] In Nicaragua, farmers were given only 10% of the market price for the coffee they produced, while the government kept the remainder.[72] Although the Sandinista government did improve urban conditions, life on the coffee farms worsened and several disillusioned farmers and laborers formed the Contra movement in an attempt to overthrow the communist regime. The Contras, supported by the US government, made incursions from bases in Honduras and attempted to disrupt the coffee harvest.[73] When President Ronald Reagan banned Nicaraguan imports, Thanksgiving Coffee owner Paul Katzeff imported Nicaraguan beans through Canada and donated $.50 a pound to the Sandinistan farmers.[74] At the same time, two other groups formed in North America –Equal Exchange in Massachusetts and Bridgehead in Canada –and offered "fair trade" Nicaraguan coffee.[75]

European socialists were also concerned with the coffee cultivation system and, independently from the North American movement, Dutchman Bert Beekman entered into a debate with the Dutch roaster Douwe Egberts about selling fair trade coffee. However, this subsidiary of Sara Lee never agreed to sell fair trade coffee, so Beekman and other fair trade advocates decided to create their own fair trade brand. A group of smaller roasters approached Beekman and offered to launch the coffee if the advocates created a certification label. In 1988, Beekman launched the Max Havelaar Quality Mark in Holland and the label quickly appeared in Switzerland, Belgium, Denmark, France, Germany, and Austria.[76] Since Max Havelaar was introduced in 1988, 17 countries had developed a fair trade seal. In 1997, an umbrella group called the Fairtrade Labelling Organizations International (FLO) was formed to coordinate monitoring and certification processes. There were 277 cooperatives from 24 countries representing 550,000 farmers that produced coffee on the Fair Trade Registry in 2001.[77] FLO estimated that in 2000, farmers produced 165 million pounds of coffee but only 29.1 million were actually sold as fair trade coffee with a retail value of $393 million.[78]

Four main criteria for fair trade coffee greatly affected the number of farmers this system could influence. The criteria were that roasters and importers:

- Purchased directly from small farmers who cultivated less than 3 hectares of land. These farmers had to be organized into democratically run cooperatives;
- Paid a guaranteed price of $1.26 for arabica, $1.06 for robusta, and $1.41 for organic beans. If the market price was above these levels, farmers received a $.05 premium over the market;
- Offered farmers advanced financing to help cover costs; and
- Developed long-term relationships with cooperatives.

Unlike organic certification, roasters and importers signed a licensing agreement to sell fair trade beans with the fair trade certification agency. The licensing fee paid for some of the certification and monitoring costs.[79] Thus, roasters and importers paid a floor price and a licensing fee for fair trade beans.

On the whole, fair trade coffee was a small fraction of the overall coffee market in 2001 in both producing and consuming countries. An estimated 75% of coffee farmers worldwide are smallholder farmers who harvest approximately 1,000 – 3,000 pounds of coffee a year.[80] Farmers working with fair trade cooperatives are typically such smallholder farmers. However, many smallholder farmers could not join cooperatives due to such factors as their isolated location. And without a cooperative, individual farmers could never amass the quantity necessary to export directly to consuming countries.[81] The 165 million pounds produced in 2001 was 1.2% of the total global output and influenced only 2.2% of the farmers and workers in coffee producing countries. This model effectively ignored the plight of workers on large coffee estates.[82] However, coffee insiders said there was a long backlog of cooperatives asking for certification but that FLO was hesitant to add more farmers since much of the fair trade coffee was not bought at fair trade prices.[83] Although consumer knowledge of fair trade coffee had continued to grow in the 1990s, purchasing patterns did not always reflect this. European countries developed fair trade labels well before the United States and Canada, but fair trade coffee market share had flattened out by 2001. Holland, which introduced the fair trade label in 1988, had a 2.7% fair trade market share and was one of the higher percentages in Europe.[84] Adoption was somewhat sporadic and depended greatly on the consumer sentiment. In 1992 Germany, France, and Switzerland all adopted the label but had a 1%, .1%, and 3% market share respectively in 2001.[85]

TransFair USA

As fair trade coffee caught on in the United States, a number of organizations sprung up to raise awareness and promote it to specialty coffee companies. TransFair USA was one of these. Paul Rice, TransFair's Executive Director, had worked in the coffee industry for almost 20 years in a variety of roles. For 11 years, he worked as a rural development specialist in the mountainous Segovias region of Nicaragua, where he founded and led a highly successful organic coffee export cooperative called PRODECOOP. Rice returned to the United States in 1994 and started a nonprofit consulting business called New Ways to Work and consulted for major foundations, international economic development organizations, and coffee farmer co-ops. In mid-1998, Rice wrote a business plan for TransFair and received $100,000 in seed financing from the Ford Foundation.[86]

With that initial funding, TransFair opened a small office of just two people and quickly got to work implementing its strategy of promoting fair trade coffee to all of the "nodes" in the consuming country's supply chain. Rice, who became TransFair's Executive Director, saw the organization's role as being a friend of the industry who had to show importers, roasters, and retailers that the fair trade model was a win/win situation. By linking farmers directly to the consuming supply chain, TransFair could help build an important relationship that would ultimately protect roasters, and retailers source of supply. "TransFair USA needed to be an indispensable part of the partnerships we're trying to create," Rice explained. "We had to show that this model is profitable, otherwise fair trade coffee will just be perceived as charity."[87]

Since importers are at the first node of the chain, for the first six months of its existence TransFair concentrated on finding importers who would buy fair trade coffee. Through this process, the organization discovered new coffee sources and acted as a sales force to roasters.[88] "Without the infrastructure already in place, TransFair couldn't begin to talk to roasters or even retailers," said Rice. In early 1999, TransFair USA launched its label with a promotional campaign at the Specialty Coffee American Association's tradeshow. Realizing that specialty consumers demanded high quality coffee and were less price-conscious than others, TransFair USA focused exclusively on bringing fair trade coffee to the specialty industry. After signing up a dozen or so importers, TransFair moved to the second node of the import chain and began talking with roasters.[89]

Global Exchange

Founded in San Francisco in 1988, Global Exchange worked to increase awareness in the United States and abroad about the roles that giant corporations play in world markets. As the popular leader of the "anti-globalization" movement, Global Exchange's main complaint was the trend of companies moving their assets toward the cheapest labor sources to maximize profits. This movement claimed that corporations had eluded monetary controls and thus had helped widen the divide between the world's rich and poor.[90] Global Exchange believed its role was to help critique the system, engage the rulemakers of the global economy, and present an alternative vision to the policies of the World Trade Organization (WTO) and International Monetary Fund. "We're a catalyst organization. We help bring these issues into the mainstream by showing people that they can become active in their communities and make a difference on a global scale," explained Deborah James, Global Exchange's Fair Trade Director.[91] In the mid-1990s, the organization successfully brought sweatshop labor practices and anti-globalization sentiment into the mainstream through its anti-Nike campaign and was an active participant in the WTO protests in Seattle in late 1999.[92]

In addition to educating and mobilizing grass-roots groups, Global Exchange was the only non-governmental activist organization that sold fair trade products. During the early 1990s, Global Exchange opened two fair trade stores in the San Francisco Bay Area to sell and promote third world artisan and other fair trade commodity products. In June of 1999, Global Exchange began a fair trade coffee promotional campaign in the San Francisco area to generate media awareness, educate the public, and create demand. Throughout that fall, as part of the campaign, Global Exchange organized, pitched and sent materials to over 130 college and local communities. Some of the campuses asked to be part of the Farmers Tour, where Central American farmers came to schools and provided a first-hand account of living conditions in their countries. The objective was to teach college students how they could make their own campus sustainable by pressuring their food service suppliers to either switch to fair trade coffee or develop a new food service contract with a company that offered fair trade coffee.[93]

At first, Global Exchange's fair trade campaign did not have a corporate angle. However, the organization's leaders soon realized that they could increase consumer awareness if they linked poor labor conditions to a company's core product. They decided to focus their attention on Starbucks. "It's the company people love to hate," said James, "and it made sense to pick them."[94] The company's critics pointed to "questionable" real estate practices and a tendency to put local establishments out of business, and focused on Starbucks as one of the brands responsible for a homogeneous culture.[95] Not only did Starbucks claim to be socially responsible without backing it up, they argued, but it had a visible national presence through its retail locations. Those very retail locations provided Global Exchange with places to gather for rallies and demonstrations.[96]

As the fall of 1999 progressed and Deborah James began developing Global Exchange's anti-Starbucks angle, the rest of the organization was busy preparing for the WTO protests by mobilizing other grass-roots groups and holding nonviolent training sessions. The weekend prior to the actual WTO meeting, Global Exchange planned three sweatshop demonstrations. As the weekend progressed, more and more people joined in, and the largest rally Global Exchange had ever helped to organize took place on Sunday, November 28, 1999 in front of a downtown Seattle Starbucks store.

Starbucks and Fair Trade Coffee

In August 1999, Ben Packard attended a meeting in Seattle on behalf of Starbucks about sustainable coffee. During this meeting, Ben met Paul Rice and learned about TransFair USA and the fair trade coffee campaign. Prior to the WTO, in November 1999 Paul flew to Seattle and met with representatives from Starbucks' Corporate Social Responsibility, Coffee, and Marketing departments to pitch fair trade coffee. In addition to explaining the certification process and how the program worked, Rice argued the benefits of the fair trade model to both farmers and businesses, and the importance that certification brought toward Starbucks' credibility. Although roasters could claim that they paid a high price for quality beans, the fair trade model ensured that cooperatives received the fair price and wasn't spread out to others along the value chain. He suggested several importers Starbucks could contact to receive samples and offered to accompany Starbucks coffee buyers on visits to some of the Fair Trade Registry cooperatives in the future. "I didn't have any expectation that they would sign up immediately," Rice said. "They had concerns and I knew it would take a couple of months to address them."[97]

In early 2000, Global Exchange turned up the heat on Starbucks. In February a local San Francisco TV station aired a two-part segment on child labor in Guatemalan coffee farms, and Global Exchange hosted its first protest in front of a downtown Starbucks the day after the first segment aired. "Our hope was to generate media attention and we did. That night the local station introduced the second segment with a clip on our demonstration," explained Deborah James. A few days later, James flew to Seattle and attended the Starbucks shareholder meeting along with Medea Benjamin (who led Global Exchange's anti-Nike campaign) and other Global Exchange employees. Besides setting up a table and serving fair trade coffee to shareholders before the meeting began, Benjamin took the microphone during the open forum portion and asked why Starbucks wouldn't offer fair trade coffee. As James described it, "Things got heated and we were physically removed from the meeting. However, we met with Sue Mecklenburg afterwards and explained our demands. If Starbucks didn't offer fair trade coffee in all of its US stores we would conduct a nationwide campaign."[98] Global Exchange promised Starbucks that they would launch a National campaign in mid-April during their planned anti-globalization rallies scheduled for Washington, DC during the IMF and World Bank meetings. "Obviously they don't want to become the Nike of the coffee industry," said James. "But we felt that they weren't moving fast enough and that their quality argument was just a pretext for not accepting any fair trade coffee. We believed this was the way to get the CEO to buy into fair trade coffee."[99]

For Starbucks, the real issues were brand and consumer proposition. Starbucks hesitated to sign a fair trade license, not wanting to commit until it had carefully weighed all of the implications.[100] According to Starbucks executives, their chief concern with fair trade coffee was finding top quality beans from cooperatives that had not demonstrated an ability to produce quality beans to Starbucks standards. From earlier cupping analyses, Starbucks had little evidence that fair trade coffee met its quality standards. Starbucks was beginning to move toward purchasing more of their coffee through direct relationships with exporters or farmers and negotiated a price based on quality. The company was willing to pay higher prices for great quality beans and had developed long-term contracts with many of its suppliers.

Mary Williams, Senior VP of the coffee department, was known throughout the coffee industry as a "tough cupper" who would not settle for anything less than top quality beans and explained, "the relationships I have with farmers were built over the last 20 years. It's taken some of them years before I would use their beans consistently and pay them $1.26 or more. Now I was being asked to use another farmer who I didn't know and pay him the same price without the same quality standards?"[101] On average, farmers sent samples and met with Starbucks coffee buyers at their farms for at least two years before Starbucks accepted their beans. In weighing the fair trade coffee issue, Williams had secondary concerns with how the farmers she worked with would react when they discovered that other farmers received the same price without being held to the Starbucks quality standards. This was not a trivial issue because it was more expensive to grow high quality beans. Further, she feared that the smaller cooperatives would not be able to guarantee that they could take back a low quality shipment and replace it based on Starbucks' volume and quality needs.

Starbucks was also concerned about its brand exposure if the quality of fair trade coffee turned out to be very different from the rest of its 30 whole bean coffee line. Coffee quality was a critical component of the Starbucks brand and if it was compromised the value of the brand could be seriously diminished. "Honestly, we didn't want to put our brand at risk," said Tom Ehlers, Vice President of the Whole Bean department. "This was an uncharted category and as marketers we were concerned about endorsing a product that didn't meet our quality standards."[102] The Whole Bean department would face several challenges in introducing fair trade coffee to 3,200 stores in the US. First, it would have to come up with a good story for fair trade coffee. "A lot of our business is about the romance of coffee—where it comes from and how to make it come alive for the customer. We weren't really sure where fair trade beans would be coming from because of the quality," explained Tim Kern, ~~a~~ Whole Bean product manager.[103] Besides confirming the marketing message and being able to communicate it effectively to both employees and customers, Kern wasn't sure Starbucks could change its product offerings as quickly as outsiders thought the company could. "It's not that easy to make changes to over 3,000 stores. We have a calendar set with coffee promotions and it takes time to create new materials and distribute them to all of our stores."[104]

And how would fair trade coffee be priced? Starbucks coffee was a high margin business, but if the company were to charge a premium for fair trade, how would customers perceive this? While pricing was a secondary issue to consider it was not a reason for Starbucks to abandon Fair Trade coffee. Orin Smith recalled, "In fact, a number of people believed that the sale of low quality Fair Trade coffee undermined their entire business proposition with customers: Starbucks and other specialty coffee companies had persuaded customers to pay high prices for quality coffee. This enabled roasters to pay the highest prices in the industry to coffee sellers." If quality was reduced specialty coffee would be no different than mass market coffee and the consumer would be unwilling to pay premium prices. This would destroy the industry's ability to pay price premiums to producers. According to Smith, "the best way to improve the standard of living for farmers is to expand the specialty coffee industry by persuading more consumers to buy quality coffee. While some consumers are persuaded to pay premium prices to help farmers, most are not willing to pay high prices regardless of quality."[105]

The Fair Trade Decision

Starbucks defined being a socially responsible corporation "as conducting our business in ways that produce social, environmental and economic benefits to the communities in which we operate."[106] Not only were consumers demanding more than just a "product," but also employees were increasingly electing to work for companies with strong values. . In a 1999 survey by Cone Communications, 62% of respondents said they would switch brands or retailers to support causes they cared about.[107] Another survey conducted in 2001 showed that 75 – 80% of consumers were likely to reward companies for being "good corporate citizens" while 20% said they'd punish those who weren't.[108] The company cared about being a responsible corporation for a variety of reasons: increasing employee satisfaction, maintaining quality supply sources, obtaining a competitive advantage through a strong reputation, and increasing shareholder value.[109]

As he looked out over the busy port in Seattle's South of Downtown district, Orin Smith pondered all of these issues. At 5 PM, he was to meet with his executive team to hear their concerns and issues before making his decision. Smith anticipated that he would hear varying viewpoints about fair trade coffee and decided to list the major concerns from the different department heads (Please see Exhibit 4).

- Mary Williams: As the SVP of Coffee at Starbucks, her major concern was about the quality of the beans. Smith knew it would be much harder to get consistent quality from these smaller cooperatives, but was it impossible? Should Starbucks make a promise to offer fair trade coffee without knowing if the company could deliver?

- Dave Olsen: As the SVP of CSR, he and others in that division were passionate about finding sustainable coffee sources. Smith knew Olsen would argue that supporting these farmers would ultimately help protect Starbucks sources while at the same time be consistent with Starbucks values. Was this model just a philanthropic measure because fair trade farmers were not graded on quality?

- Wanda Herndon: As the SVP of Worldwide Public Affairs, her major concern was the message Starbucks would send to customers, investors, supply sources, and activist groups. Smith knew that although Starbucks' central message was that the customer came first, this demand was coming from an activist group and not from Starbucks customers. Would it appear as if Starbucks were "giving in" to activist groups if they offered fair trade coffee? And what would happen the next time another group came to Starbucks with a demand?

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

Exhibit 1a: Starbucks Financial Statements

Income Statement[110]

(in thousands)

	2000	1999	1998	1997	1996
Net Revenue	$2,177,614	$1,686,828	$1,308,702	$975,389	$697,872
Joint Venture Income	$20,300	$3,192	$1,034		
Interest Income	$7,110	$7,315	$7,134	$12,393	$11,029
Gain in Sale					$7,827
Total Revenue	$2,205,024	$1,697,335	$1,316,870	$987,782	$716,728
Cost of Sales	$961,885	$747,630	$578,483	$436,942	$335,800
Store operating expense	$704,898	$543,572	$418,476	$314,064	$210,693
Other operating expense	$78,445	$54,629	$44,513	$28,239	$19,787
Depreciation & amortization	$130,232	$97,797	$72,543	$52,801	$35,950
General admin expense	$110,202	$89,681	$77,575	$57,144	$37,258
Merger expense			$8,930		
Interest expense				$7,282	$8,739
Investment losses (internet)	$58,792				
Total Costs	$2,044,454	$1,533,309	$1,200,520	$896,472	$648,227
EBIT	$160,570	$164,026	$116,350	$91,310	$68,501
Income Taxes	$66,006	$62,333	$47,978	$36,099	$26,373
Net Earnings	$94,564	$101,693	$68,372	$55,211	$42,128

Exhibit 1b: Starbucks Financial Statements

Balance Sheet (in thousands)

	2000	1999	1998	1997	1996
Assets					
Cash	$70,817	$66,419	$101,663	$70,126	$126,215
Short-term investment	$61,336	$51,367	$21,874	$83,504	$103,221
Accounts receivable	$76,385	$47,646	$50,972	$31,231	$17,621
Inventory	$201,656	$180,886	$143,118	$119,767	$83,370
Prepaid expenses	$18,736	$19,049	$11,205	$8,763	$6,534
Deferred income tax	$29,304	$21,133	$8,448	$4,164	$2,580
Total current assets	$458,234	$386,500	$337,280	$317,555	$339,541
Joint ventures	$52,051	$42,718	$38,917	$34,464	$4,401
Other investments	$3,788	$25,342			
PP&E	$930,579	$760,289	$600,794	$488,791	$369,477
Other assets	$25,403	$23,474	$15,685	$16,342	$13,194
Goodwill	$21,311	$14,191	$79		
Total Assets	$1,491,366	$1,252,514	$992,755	$857,152	$726,613
Liabilities					
Accounts payable	$73,653	$56,108	$49,861	$47,987	$38,034
Checks drawn	$56,332	$63,811	$33,634	$28,582	$16,241
Accrued compensation	$69,702	$43,872	$35,941	$25,894	$15,001
Accrued occupancy	$35,841	$23,017	$17,526	$12,184	$7,976
Accrued taxes	$29,117	$30,752	$18,323	$12,946	$7,114
Other accrued expenses	$39,016	$32,480	$24,190	$30,829	$20,834

Accrued interest					$3,004
Deferred revenue	$7,320	$484			
Current portion long-term debt	$685	$673			
Total current liabilities	$311,666	$251,197	$179,475	$158,422	$108,204
Convertible debentures				$165,020	$166,749
Long-term deferred income tax	$21,410	$32,886	$18,983		
Long-term debt	$6,483	$7,018			
Total Liabilities	$339,559	$291,101	$198,458	$323,442	$274,953
Equity					
Common stock	$376				
Additional paid-in capital	$750,496	$651,020	$589,214	$391,284	$361,309
Retained earnings	$408,503	$313,939	$212,246	$142,426	$90,351
Accumulated loss	($10,976)	($3,946)	($7,163)		
Total Shareholder Equity	$1,148,399	$961,013	$794,297	$533,710	$451,660
Minority Interest	$3,588	$400			
Total Liabilities & Equity	$1,491,546	$1,252,514	$992,755	$857,152	$726,613

Exhibit 2: Starbucks Mission Statement

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

Provide a great work environment and treat each other with respect and dignity.

Embrace diversity as an essential component in the way we do business.

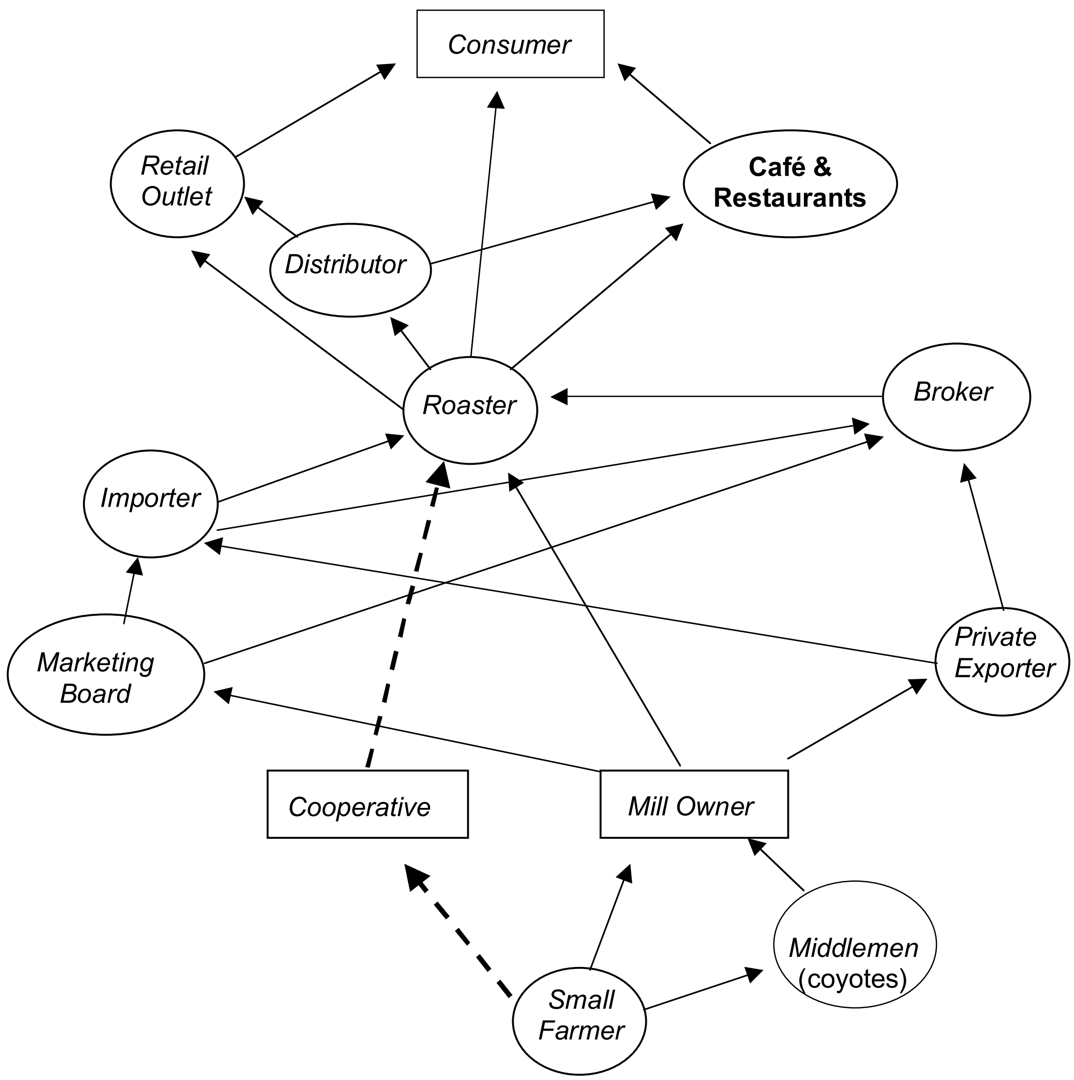
Apply the highest standards of excellence to the purchasing, roasting and fresh delivery of our coffee.

Develop enthusiastically satisfied customers all the time.

Contribute positively to our communities and our environment.

Recognize that profitability is essential to our future success.

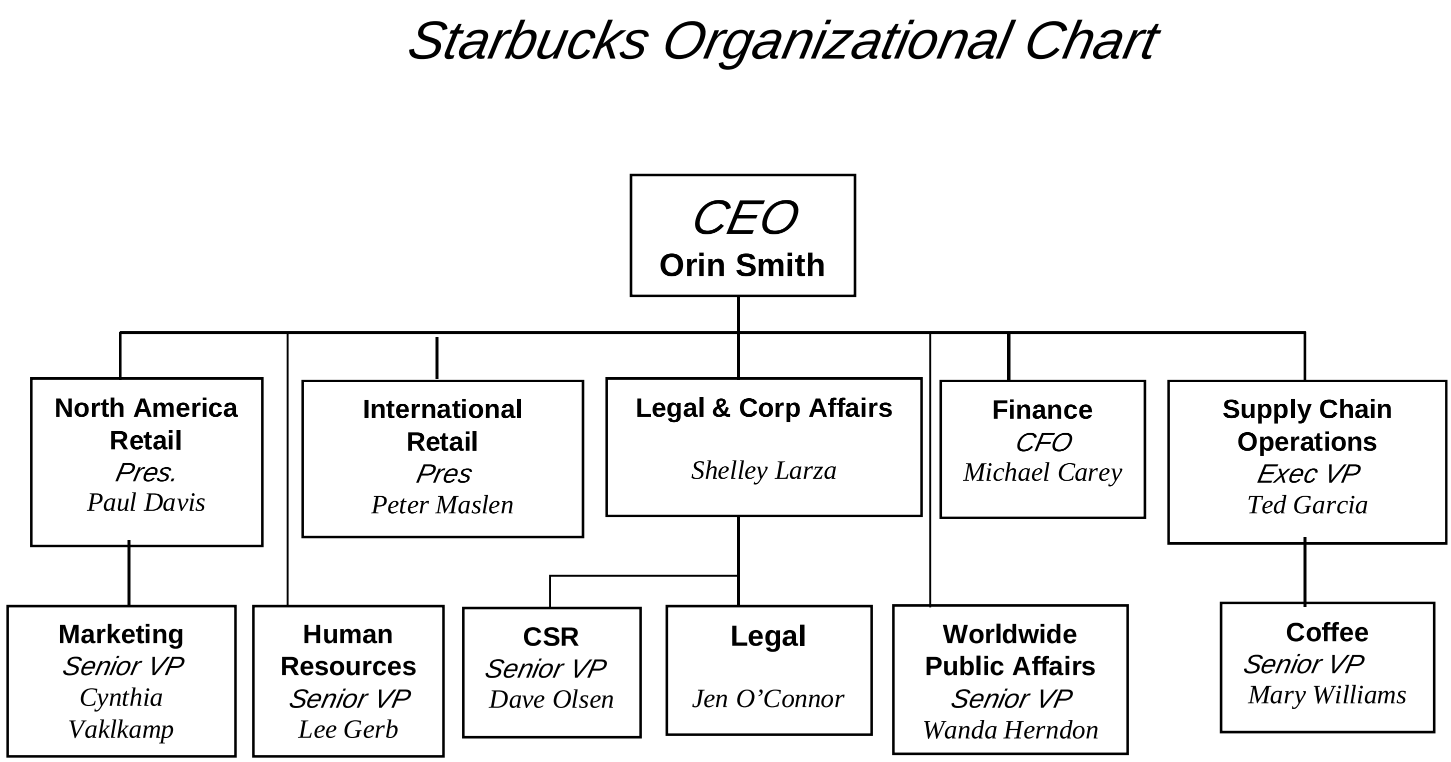
Exhibit 3: The Coffee Distribution System



Source: The Coffee

The dotted lines represent fair trade coffee relationships as proposed by the fair trade model.

Exhibit 4



Source: Reconstructed through interviews with Starbucks

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[48] Pendedergrast, pg. 418.
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[50] Dicum & Luttinger, pg. 38.
[51] This percentage varies depending on how large small-scale farms are described. In one source, small-scale farms are less than 5 acres (50%), in another, less than 10 acres (70%).
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[61] Pendergrast, pg. 396.
[62] Ibid, pg. 47.
[63] Bock, pg. 7.
[64] Giovannuci, pg. 19. The two main certifying agencies for shade-grown coffee are the Smithsonian Migratory Bird Center and Eco-OK. When asked in the SCAA survey, several responded with different certifiers who are in fact are not recognized as certifying agencies.
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