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Starbucks' Human Resource Management Policies and the Growth Challenge

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"The relationship we have with our people and the culture of our company is our most sustainable competitive advantage."

-Howard Schultz, chairman and chief global strategist of Starbucks, in 2002.[1]

"My biggest fear isn't the competition, although I respect it. It's having a robust pipeline of people to open and manage the stores who will also be able to take their next steps with the company."

-Jim Donald, president, Starbucks North America in 2005.[2]

INTRODUCTION

In January 2005, when Starbucks Coffee Company (Starbucks) was placed second among large companies in the *Fortune* "Best Companies to Work For" survey, it was no surprise to those familiar with the company's human resources management policies and work culture.

In general, the retail industry is notorious for its indifferent attitude towards employees. Despite the fact that employees, especially those on the frontline, are critical to the success of retail businesses, most companies do not have a strong relationship with their employees, and consequently suffer from a high rate of employee turnover (In the early 2000s, employee turnover in the retail industry was around 200 percent).

In this scenario, Starbucks stood out for its employee-friendly policies and supportive work culture. The company was especially noted for the extension of its benefits program to part-time workers – something that not many other companies offered. As a result, Starbucks employees were among the most productive in the industry and the company had a relatively low employee turnover.

Though it was popular as an employer, Starbucks' main challenge in the early 2000s was whether it would be able to continue to attract and retain the right kind of employees in the right numbers, to man its rapid expansion program. Although it experienced slow growth in the initial years the company expanded rapidly after its Initial Public Offer (IPO) in 1992 and grew at an average rate of around 20 percent per annum.

Analysts said that, in the light of its ambitious expansion program, Starbucks' generous human resource policies made sound strategic sense, as they kept the turnover low and provided a ready pool of experienced employees to support expansion. However, by the early 2000s, three possible problems had to be considered – would the company be able to support its staff with the same level of benefits in the future, given the large increase in the number of employees; would the company be able to retain employees if it made any move to lower its human resource costs by cutting down on benefits; and would Starbucks be able to maintain its small company culture, an important element in its past growth.

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1 "The Culture Connection," www.apm.com, June 2002.

2 Gretchen Weber, "Preserving the Starbucks' Counter Culture," Workforce Management, February 2005.

BACKGROUND

Starbucks was founded in 1971, by three coffee lovers, Gordon Bowker (Bowker), Jerry Baldwin (Baldwin), and Zev Siegl (Siegl). Baldwin and Bowker were fond of Peet's coffee, which they drank when they were at college in San Francisco. Even after they moved to Seattle, they continued ordering Peet's coffee by mail. On one such occasion, Bowker got the idea of opening a coffee shop in Seattle to supply world-class coffee to Seattle residents. He talked it over with Baldwin and his neighbor Siegl, and together, the trio set up the first Starbucks store in Seattle. (Starbucks originally sold only whole bean coffee. The coffee bar concept evolved much later).

Starbucks grew at a slow pace initially and at the end of its first decade (1981), there were four Starbucks stores. The partners also opened a roasting plant in Seattle. In 1981, Howard Schultz (Schultz), a housewares company executive from New York, became interested in Starbucks. He went to Seattle to meet the partners and learn more about the business. What he saw of Starbucks interested Schultz immensely, and he soon convinced the partners to hire him in a marketing position at the company.

The turning point came in 1983, when Schultz visited Italy, where he learnt about the Italian coffee bar culture. Schultz saw the potential of serving ready-to-drink coffee by the mug, and suggested introducing the concept in the US. The partners however, were reluctant to extend their brand into espresso drinks, and it took Schultz a year to convince them of the potential of the idea. Eventually, Starbucks started serving espresso coffee in 1985, when it opened its sixth store in downtown Seattle. The concept was an immense success and within two months, the store was serving over 800 customers a day (espresso sales were much higher than sales of the best selling whole bean coffee).

Schultz was keen on extending this concept to the other stores as well, but Baldwin believed that selling beverages distracted the company from the core business of selling top quality, whole bean coffee. Eventually, in 1985, Schultz left Starbucks and started his own coffee bar called Il Giornale. Bowker and Baldwin, along with a few private investors provided financial backing for this venture, and Starbucks supplied the coffee beans. Schultz had opened Giornale in partnership with Dave Olsen (Olsen), who was previously the owner of Café Allegro, a coffee bar. Olsen and Schultz had a strong partnership as Schultz took care of the external aspects of the business, while Olsen brought his experience to the making and serving of coffee.

In 1987, Baldwin, Bowker and Siegl decided to sell Starbucks, with its six retail stores, roasting plant, and the corporate name. Schultz, along with a group of local investors bought Starbucks for $3.7 million. Eventually, he changed Giornale's name to Starbucks Coffee Company, and merged the two businesses.

Starbucks grew rapidly under Schultz's leadership. During the late 1980s, the company expanded into Chicago, Vancouver and Portland, and Schultz promised investors that Starbucks would have 125 locations by the early 1990s. In 1989, Schultz brought in Howard Behar and Orin Smith (Smith) to Starbucks in top financial and operational positions. The three of them worked well together and the company expanded rapidly.

By the early 1990s, Starbucks had over 110 stores. The company had also explored new avenues of business such as mail order catalogues, and licensing coffee bars at airports. In 1992, Starbucks issued shares to the public at $ 17 per share. The money raised from the public issue was ploughed into expansion and by the mid-1990s Starbucks had expanded overseas, with stores in Japan and Singapore. The number of stores around the world exceeded 1000. The company adopted a mixed approach for expansion, partly setting up its own stores and partly through licensing.

During the 1990s, the company extended its brand in a variety of ways through strategic alliances. It entered into an agreement with United Airlines to serve Starbucks coffee on flights, started selling brands of tea through its Tazo Tea Company subsidiary, introduced coffee-flavored ice creams with Dreyers, and a coffee-flavored cola drink with PepsiCo, and distributed its whole bean coffees through Kraft stores. Stores also continued to expand rapidly. The strategy adopted by Starbucks was to blanket a region with its new stores. By doing so it could reduce the rush of customers to one store and also increase its revenues through new stores. This helped the company to reduce its distribution costs and the waiting period for customers in its stores, thereby increasing the number of customers.

In 1999, Schultz stepped down as CEO in favor of Smith (who was then the president and COO), but continued to play an active role in the company as chairman and chief global strategist. By the early 2000s, Starbucks was one of the most well recognized brands in the world. In fiscal 2004, the company had revenues of $5.29 billion, which marked a 30 percent growth over 2003. (Refer Exhibit I for Starbucks' Income Statement). By the end of 2004, the company had around 8,900 stores in 35 countries across the world. It had opened 1,344 new stores in 2004 and announced plans to open 1,500 in 2005. In 2004, Starbucks also raised its eventual worldwide retail target from 25,000 outlets to 30,000 outlets, with 15,000 in the US alone.

HUMAN RESOURCES MANAGEMENT AT STARBUCKS

Starbucks realized early on that motivated and committed human resources were the key to the success of a retail business. Therefore the company took great care in selecting the right kind of people and made an effort to retain them. Consequently, the company's human resource policies reflected its commitment to its employees.

Starbucks relied on its baristas and other frontline staff to a great extent in creating the 'Starbucks Experience' which differentiated it from competitors. Therefore the company paid considerable attention to the kind of people it recruited. Starbucks' recruitment motto was "To have the right people hiring the right people." Starbucks hired people for qualities like adaptability, dependability and the ability to work in a team. The company often stated the qualities that it looked for in employees upfront in its job postings, which allowed prospective employees to self-select themselves to a certain extent.

Having selected the right kind of people, Starbucks invested in training them in the skills they would require to perform their jobs efficiently. Starbucks was one of the few retail companies to invest considerably in employee training and provide comprehensive training to all classes of employees, including part-timers.

All selected candidates were required to undergo 24 hours of training at one of the several Starbucks regional training centers before they could assume their jobs. This training program, called 'First Impressions' in North America, had a standardized curriculum that was prepared by a team of experts and was taken by experienced store managers, specialists in various fields and training experts. The aim of this program was to indoctrinate employees in the company's philosophy and train them in its service principles.

Coffee making was a science at Starbucks, and all new employees were required to understand this skill thoroughly. During the training program employees were taught the basics of retail business, coffee making skills, and the steps to take to create a positive customer experience. Some of the elements of the training program included coffee history and knowledge of the various types of coffee, using the cash register, the accurate weighing of coffee beans, cutting open coffee bags neatly, preparing and memorizing the various coffee recipes, preparing beverages according to special customer requirements, maintaining store cleanliness, service and customer interaction, among others. There were also several rules to be memorized related to the making of coffee. For instance, the temperature of milk had to be between 150 degrees Fahrenheit and 170 degree Fahrenheit, espresso shots had to be 'pulled' within 23 seconds and prepared coffee was never to be retained for more than 20 minutes in the percolator.

Employees were taught the three basic 'Star Skills', which governed interpersonal relations at Starbucks:

- Maintain and enhance self-esteem
- Listen and acknowledge
- Ask for help

Training for managers and other non-frontline employees was of a different nature. The training for management trainees extended between 8 to 12 weeks. In addition to the training imparted to the frontline staff, management training included details of store operations, practices and procedures as set forth in the company's operating manual, information systems, basics of managing people, diversity training, etc. Sometimes, management staff were required to work for some time in stores to enable them gain a better understanding of coffee-making and serving. Employees were also encouraged to attend outside training programs and seminars, which Starbucks reimbursed when necessary.

Starbucks' training program was appreciated by employees, who reported that they felt valued and important when the company invested significantly to help them prepare for their jobs.

What Starbucks was best known for was its benefits program, which covered part-time workers as well as full timers. Starbucks instituted its benefits program in the early 1990s and was one of the few private companies to offer comprehensive benefits to part-timers (This was significant as a major proportion of the company's workforce comprised of part-timers). The company's benefits program had its roots in Schultz's philosophy, which was to "treat people like family, and they will be loyal and give their all." In keeping with this philosophy, Starbucks designed a work/life balance program that took into consideration the physical, mental and spiritual wellbeing of its employees.

The wages that Starbucks paid were among the highest in the industry. Although Starbucks did not reveal information about its total wage bill, independent analysts estimated in 2005 that the most common hourly job, that of a coordinator came with an average pay of $35,294 a year, and the most common salaried position, store manager, received $44,790 per year. The pay per hour exceeded the minimum wage as stipulated by state regulations by a reasonable margin. In addition to this, the company offered comprehensive health benefits, stock options and several other perks to its employees.

Employees who worked a minimum of 20 hours a week and had completed 90 days of service were eligible for health insurance coverage. The company paid 75 percent of the premium of the health insurance, and the balance was paid by the employees. Coverage varied depending on the personal requirements of each employee. Dental and vision insurance were also a part of the benefits program, as were reimbursements for alternative treatments like hypnotherapy and naturopathy.

Schultz played a key role in developing an employee ownership program at Starbucks soon after he bought the company in 1987. He believed that employees were more motivated when they had a stake in the company's performance, and hence contributed better. In 1990, an internal development team took on the task of creating a stock option plan that would involve partners more deeply in the company and give them a real stake in it. In 1999, the 'Bean Stock' Plan came into operation, making Starbucks the first company to give stock options to part-time workers. (The fact that all employees were eligible for options was one of the reasons Starbucks called its employees 'partners', indicating that they played an equal role in the company's performance.)

The Bean Stock Plan allowed employees who had completed six months at Starbucks and worked a minimum of 20 hours a week to become eligible for stock options. The amount of options that employees were eligible for depended on factors like their annual salary, the company's performance and the price of the shares. This policy was valuable, as people who received options in the early years benefited considerably from the soaring price of Starbucks shares. "We established Bean Stock in 1991 as a way of investing in our partners and creating ownership across the company," said Bradley Honeycutt, vice president of human resource services. "It's been a key to retaining good people and building loyalty. Naturally, the level of our customer service is favorably impacted, as a result," she added.[3]

In addition to monetary benefits, Starbucks offered several programs that promoted the wellbeing of employees. The company had onsite fitness programs at several sites and provided childcare and elder care assistance to employees. A program called 'Working Solutions' helped Starbucks address the personal needs of employees by providing them the required assistance as and when the need arose. Joan Moffat (Moffat), manager of partner relations, made use of Working Solutions to find elder care services for her ailing grandmother. Another partner used it to find emergency childcare for his son who was ill. The program assisted employees in finding solutions to problems and Starbucks even reimbursed part of the expenditure. This way, there was no need for employees to miss work. "Working Solutions style of caring and support complements our work/life program, and helps ensure the quality our partners deserve," said Moffat.[4]

Another example of Starbucks' 'wellness' programs was 'Partner Connection', a program that was designed to link partners sharing similar interests from across the organization. Interests were varied, ranging from social and recreational topics to parenting and volunteerism. There were over 25 informal groups in Starbucks' Seattle headquarters itself, and several groups operated in other regions as well. Some of Starbucks' informal groups were 'The Wonderful World of Food' group and 'The New Parent Network'. There was also a Starbucks Soccer Group and a Starbucks Choir. Analysts said that Partner Connection succeeded because the onus for running it was on the partners themselves and involved minimal cost to the company, although the company supported it. Other employee perks included a 30 percent discount on Starbucks branded merchandise, discounted beverages and a free pound of Java coffee every week.

Flexibility was one of the key aspects of Starbucks human resource policies, and extended to all areas of people management. In the early 2000s, Starbucks began offering flexible work schedules to help employees achieve work/life balance. The Starbucks benefits program also offered a flexible arrangement for employees to choose their own benefits, in contrast to the 'one-size-fits-all' approach adopted by several other companies. The Starbucks Total Pay Package was referred to as "Your Special Blend" because it was unique to each employee. Employees could participate in a variety of programs and choose the composition of their compensation based on individual needs and preferences.

Starbucks also conducted employee surveys on a regular basis to monitor employee feedback and to gauge whether the benefits programs were showing the desired results or not. For instance, based on employee responses in one of these surveys, Starbucks began reimbursing one eye exam per year and paid part of the cost of contact lenses every year and frames every other year. The company also began reimbursing mental health treatments in 1994. Human resources management experts said that Starbucks' benefits program was designed to attract and retain top people who were eager to work for the company and committed to excellence.

Analysts said that Starbucks' work culture played an important role in helping the company recruit and retain top employees. The company's culture had its roots in the mission statement that was drafted in 1990, and clearly reflected the company's values. (Refer Exhibit II for Starbucks' Mission Statement). That Starbucks put its employees' welfare before any other factor was evident from the company's principles, the first of which stated the company's objective to be to "provide a great work environment and treat each other with respect and dignity."

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3 Naomi Weiss, "How Starbucks Impassions Workers to Drive Growth," Workforce Management, August 1998.

4 Naomi Weiss, "How Starbucks Impassions Workers to Drive Growth," Workforce Management, August 1998.

The mission statement had great value at Starbucks and the company made an effort to keep the mission alive in the minds of employees. Each employee was given a copy of the mission statement on joining the company and the mission was regularly reiterated at all company gatherings and meetings. All company decisions were based around its guiding principles and during critical presentations, the management constantly related decisions taken to the relevant guiding principles.

The most important factor however, was the 'Mission Review' program that allowed all partners to comment on any decision or action of the company relating to the degree of its consistency with one of the six principles laid out in the mission statement. This activity was taken very seriously at Starbucks, and the person most knowledgeable about the matter on which the comment had been made, was required to respond within two weeks of the comment being made, either personally or through the company's monthly report. It was estimated that approximately 200 Mission Review queries were made every month at Starbucks. The mission statement was even printed at the back of employees' business cards.

In its effort to 'treat people with respect and dignity', Starbucks adopted several values that guided behavior within the organization. One of the most important among these was equality. This was the reason for the company calling all its employees, regardless of rank, 'partners'. It indicated that all employees had the right to own stock in the company and contribute equally to its progress. The company also had the practice of not capitalizing job titles. For instance, the job title would be 'ceo and president' rather than 'CEO and President'. This was designed to mean that no person was more important than others in the organization and emphasized humility.

Even when growing at a rapid pace, Starbucks made an effort to retain a small company atmosphere, to encourage the entrepreneurial spirit of employees. For instance, members of the top management often called up stores at random to speak to managers and to say 'thank you' to employees in instances of exemplary service. The company felt this was important as Starbucks was growing at a rate of 20 percent a year in the early 2000s. "If any company doesn't have the time to talk to people on the front lines, then you might as well close it up, because it's not going anywhere," said Jim Donald, who was set to take over as Starbucks' CEO in March 2005 replacing Orin Smith.[5]

Informality and camaraderie were the natural outcomes of maintaining a small company atmosphere. Employees were encouraged to interact among each other and with customers with a spirit of friendliness. This was an inherent part of creating the 'Starbucks Experience', which was the company's unique selling proposition. So powerful was the Starbucks Experience, that it was estimated that the regulars returned to the outlets 18 times a month.

That Starbucks valued its employees was reflected in the fact that it empowered employees and encouraged innovativeness on their part. Some of Starbucks' most successful innovations came from employees. *Frappuccino*, a very popular cold, coffee blended beverage was the result of the ideas of a few employees. Similarly, Starbucks ventured into marketing CDs when one of the store managers began experimenting with customized in-store music tapes.

Analysts said that the fact that Starbucks implemented ideas given by employees gave them a sense of contribution and was an important factor in retention. Starbucks also instituted self-managed teams in its coffee roasting plants in the early 2000s, in an effort to bring about more empowerment. Although the teams were formed and guided by managers in the initial stages, over time, team members were encouraged to take over the day-to-day management, including decision-making.

Starbucks also recognized partner achievement through open forums and awards like Warm Regards, the MUG (Moves of Uncommon Greatness) Award, "BRAVO!," and the "Spirit of Starbucks Award".

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[5] Gretchen Weber, "Preserving the Starbucks' Counter Culture," Workforce Management, February 2005.

THE HUMAN RESOURCES' CHALLENGE

Analysts said that Starbucks biggest challenge in the early 2000s would be to ensure that the company's image as a positive employer survived its rapid expansion program, and to find the right kind of people in the right numbers to support these expansion plans.

Considering the rate at which the company was expanding, analysts wondered whether Starbucks would be able to retain its spirit even when it doubled or tripled its size. By the early 2000s, the company began to show signs that its generous policies and high human resource costs were reflecting on its financial strength. Although the company did not reveal the amount it spent on employees, it said that it spent more on them than it did on advertising, which stood at $68.3 million in fiscal 2004.

That the company was finding its human resource costs burdensome was reflected in the fact that it effected an increase of 11 cents on its beverage prices in mid-2004. Analysts wondered whether the company's cost problems could be met by a price increase, as customers already paid a premium for Starbucks beverages. On the other hand, it would not be easy for the company to cut down on benefits, as it could result in a major morale problem within the company.

Most retailers dealt with this issue by restricting benefits and perks to full timers, but Starbucks could not afford to take that route as it built its reputation of being friendly to part-timers. (Refer Exhibit III). It was estimated in 2004 that about 65 percent of the company's work force comprised of part-time workers. This made a huge impact on overall human resource costs. Additionally, costs were only likely to grow as the company expanded.

The company however, justified the expenditure saying that people were the foundation of its success, and without motivated employees growth would not be possible. "We're not giving these benefits to our employees because we're a successful company. We're successful because we're giving to our people. We believe it's a fundamental way to run our business" said David Pace, an executive vice president at the company.[6] It also did not cost the company much to administer the benefits program. Health costs were low, as the company had a young work force. Similarly there was reduced absenteeism and better retention which justified high costs. However, it was apparent that health costs would rise as the employees stayed longer with the organization and grew older.

Another problem was that working at Starbucks was beginning to lose its charm as the company grew larger. By the early 2000s, there were complaints that the company had stopped caring for employees and that its image as a positive employer was only eyewash. One instance of this related to reports that Starbucks was anti-union and discouraged the formation of employee unions. Most of the employees reported that they enjoyed working for the company but said that it was not as people-friendly as it could be. Some of them also had complaints about physical problems or issues regarding wages and hours.

It was also reported that the company came down hard on any union activity and many times, people involved in forming a union lost their jobs. Analysts said that the company's attitude was that it took care of employee needs and consequently employees should feel no need to organize. However it seemed to mark the end of Starbucks' small company culture.

Employees were also not paid compensation for work-related injuries such as repetitive stress, and accidents like hot beverages spilling on them. Besides, employees argued that Starbucks did not 'give' benefits; rather, it was employees themselves who had to contribute to get the benefits. Some other complaints were that raises were paltry (sometimes just around 60 cents an hour) and that the company denied overtime pay.

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[6] Gretchen Weber, "Preserving the Starbucks' Counter Culture," Workforce Management, February 2005.

Considering this, analysts wondered about the company's recruiting prospects in the future. Besides more retail companies were waking up to the importance of keeping people happy, which further increased competition for good employees.

However, despite the concerns about Starbucks' human resources challenges in the future, it was generally acknowledged that the company was considerably more successful than any other company in the retail sector, in attracting and retaining good employees. Starbucks employee turnover was around 60 percent per year, which was less than one-third the retail industry average, which stood at 200 percent. Some baristas had been with the company for seven years or more, which was unusual for part-timers and frontline staff. In addition to this, there was a high employee satisfaction rate and in a survey conducted in the early 2000s, 82 percent of the employees reported to being 'very satisfied' with their jobs and 15 percent were 'satisfied'. Analysts said that it was a remarkable feat for a large company with over 55,000 employees.

Analysts said that Starbucks' success rested on the way it treated people. The company managed to expand rapidly because it was supported by a strong workforce. Employees were critical in creating the Starbucks Experience, which differentiated the company from competitors. "Starbucks has always understood that human resources is a fundamental cog in their business, and if they're going to sell a premium product, they need to offer premium service as well. They've invested in their workforce time and time again, and it's been critical to their success as a company," said Sharon Zackfia, an analyst at William Blair & Co. in Chicago.[7]

[7] Gretchen Weber, "Preserving the Starbucks' Counter Culture," Workforce Management, February 2005.

Exhibit I

Starbucks' Income Statement

(All amounts in millions of US dollars except share data)

PERIOD ENDING		October 3, 2004	September 28, 2003	September 29, 2002
Total Revenue		**5,294,247**	**4,075,522**	**3,288,908**
Cost of Revenue		2,191,440	1,685,928	1,350,011
Gross Profit		**3,102,807**	**2,389,594**	**1,938,897**
	Operating Expenses			
	Research Development	-	-	-
	Selling General and Administrative	2,266,109	1,765,470	1,450,447
	Non Recurring	(60,657)	(38,396)	(35,832)
	Others	289,182	237,807	205,557
	Total Operating Expenses	-	-	-
Operating Income or Loss		**608,173**	**424,713**	**318,725**
	Income from Continuing Operations			
	Total Other Income/Expenses Net	14,140	11,622	22,661
	Earnings Before Interest And Taxes	622,313	436,335	341,386
	Interest Expense	-	-	-
	Income Before Tax	622,313	436,335	341,386
	Income Tax Expense	231,754	167,989	126,313
	Minority Interest	-	-	-
	Net Income From Continuing Ops	390,559	268,346	215,073
	Non-recurring Events			
	Discontinued Operations	-	-	-
	Extraordinary Items	-	-	-
	Effect Of Accounting Changes	-	-	-
	Other Items	-	-	-
Net Income		**390,559**	**268,346**	**215,073**
Preferred Stock And Other Adjustments		-	-	-
Net Income Applicable To Common Shares		**$390,559**	**$268,346**	**$215,073**

Source: finance.yahoo.com

Exhibit II

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 five guiding principles will help us measure the appropriateness of our decisions:

- Provide a great work environment and treat each other with respect and dignity.
- Apply the highest standards of excellence to the purchasing, roasting, and fresh delivery of our coffee.
- Develop enthusiastically satisfied customers all of the time.
- Contribute positively to our communities and to our environment.
- Recognize that profitability is essential to our future success.

Source: Bob Nelson, "How Starbucks Is Offering Not Just Jobs but Careers," www.workforceonline.com.

Exhibit III

Benefits to Part-Time Workers and Full Time Workers

Type of Benefit	Percentage of US part-timers with access	Percentage of US full-timers with access
Retirement	27	68
Health care		
• Medical	20	84
• Dental	13	56
• Vision	8	35
Paid Holidays	37	89
Paid sick leave	24	70
Life insurance	10	63
Disability insurance (short-term)	14	47
Bonus and Stock Options	28	52
Employer-assisted child care	8	16

Source: BLS National Compensation Survey, March 2004.

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