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THE HBR INTERVIEW

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By the time Howard Schultz stepped down as chief executive of Starbucks, in 2000, the coffee chain was one of the world’s most recognizable brands—and on a steady trajectory of growth. Eight years later Starbucks was suffering from a rough economy and its own strategic missteps, and Schultz felt compelled to return to the CEO seat. His previous tenure had seen promising growth, but now he faced a challenging mission: to lead a turnaround of the company he had built. In this condensed and edited interview, Schultz discusses what it’s like to retake the reins in the middle of a crisis.

HBR: We thought we knew the Howard Schultz story. You had a vision, built a successful company, and moved on. But then Starbucks ran into trouble, and two years ago you had to return as CEO. How hard has it been to get things right?

Schultz: The past two years have been transformational for the company and, candidly, for me personally. When I returned, in January 2008, things were actually worse than I’d thought.

The decisions we had to make were very difficult, but first there had to be a time when we stood up in front of the entire company as leaders and made almost a confession—that the leadership had failed the 180,000 Starbucks people and their families. And even though I wasn’t the CEO, I had been around as chairman; I should have known more. I am responsible. We had to admit to ourselves and to the people of this company that we owned the mistakes that were made. Once we did, it was a powerful turning point. It’s like when you have a secret and get it out: The burden is off your shoulders.

To what extent did the financial crisis add to the management crisis?

For some reason we seemed to become the poster child for excess. It’s easy to laugh about it now, but people said that buying a latte at Starbucks wasn’t smart. McDonald’s put up billboards saying that four dollars for a coffee is dumb. Gas went as high as five dollars in some places, coupled with the financial crisis—and

all of a sudden we saw a seismic change in consumer behavior. Weekends have always been our busiest times, but people changed their driving habits. There were times during the day when we didn't have enough sales per hour to justify the labor. And this for a company that had always hit not singles or doubles but home runs. We didn't really know how to respond, because it's not something you're taught, and we'd never had any such experience. I spent a lot of time reaching out to people much smarter than me, who were managing big retail businesses and consumer brands, and I was stunned that every time I called someone, they wanted to know more from me than I could get from them, because they were in the same position. No one had any answers.

Also, you were suddenly facing serious competition.

We had never had much competition. Everything we did more or less worked. And that produced a level of hubris that caused us to over-

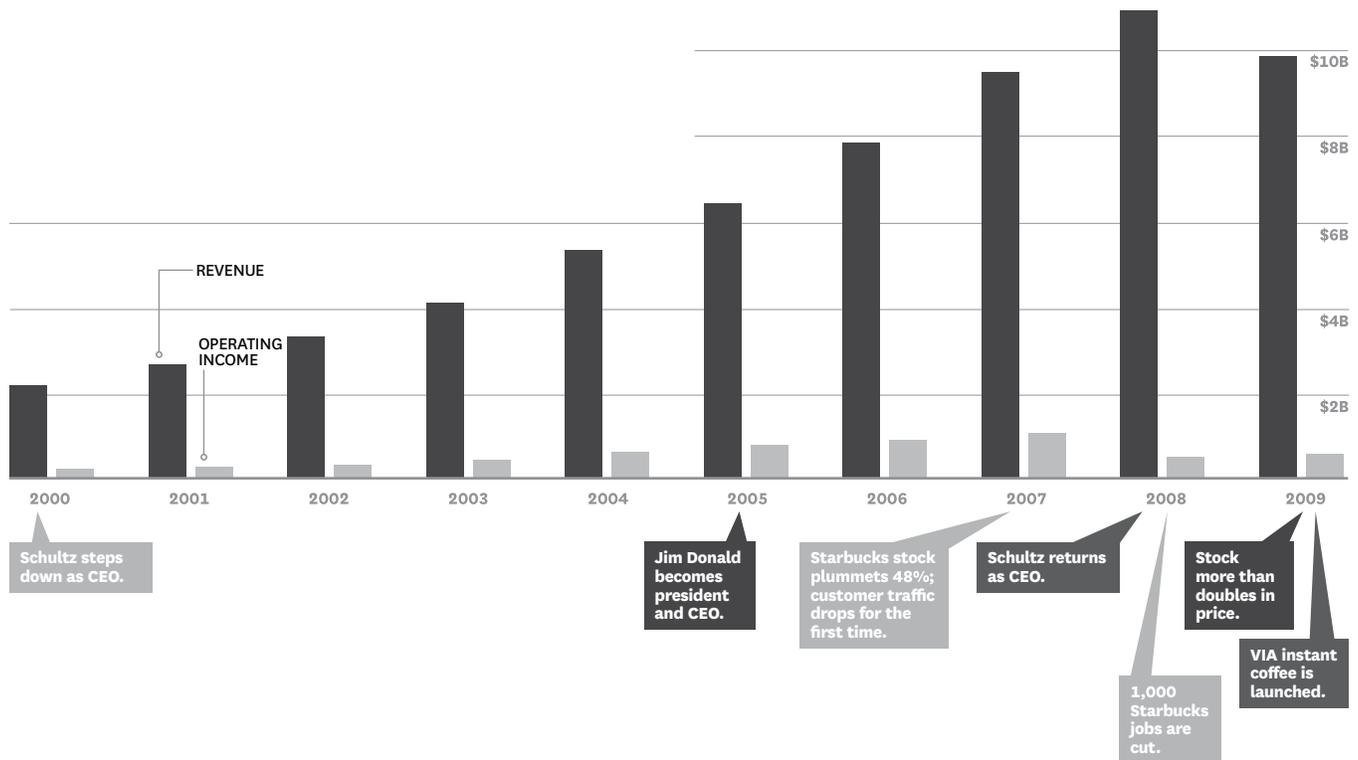
look what was coming. Big-time people began to notice that this coffee business is a good business and highly profitable. McDonald's and Dunkin' Donuts were on the very low end. Let's characterize them as willing to do anything to capture or intercept customers—free coffee, coupons, say anything, do anything. We respect them as companies, but we didn't respect their practices. At the higher end were the independents who went to school on Starbucks. And there was this feeling of “Let's support the local companies.” So Starbucks was being squeezed to the middle, and that is an undesirable place for us to be.

And by this time, bloggers were making life tough for you.

Social media suddenly started defining Starbucks. We were an easy target. Bloggers were putting holes in the equity of the brand, and it was affecting consumer confidence, our people, everything. I woke up one day and went to my desk, and I had 75 to 100 e-mails and phone

A Stark Challenge: What Schultz Is Trying to Fix

When Howard Schultz stepped down as CEO, in 2000, revenue and operating income were soaring. When he stepped up again, in 2008, the share price had dropped by almost 50%, and he faced what would become a comparable decline in operating income.



“You have to have a 100% belief in your core reason for being. Franchising the system would have fractured the culture of the company.”

calls about an issue I had never heard of. There was a sensational story in the *Sun*, in London, that Starbucks was wasting water through something called the “dipper well.” My phone rang, and it was a reporter asking me to comment on the dipper well. “I have no idea what you’re talking about,” I said. The reporter said, “Mr. Schultz, I suggest you Google Starbucks real fast.” The *Sun* claimed that we were pouring “millions of litres of precious water down the drain” as a result of the method we used to sanitize equipment. The report was wildly exaggerated, and we had been working for several years to find a better solution, but we suddenly became the target of conservation groups. We had a real problem. The lesson was that the world had changed. Something that had happened in London had created a worldwide story that positioned Starbucks with venom and disrespect. And we didn’t know how to respond. The issues of social media, digital media, and getting smart about the rules of engagement emerged as a tremendous weakness for the company. Ultimately our reputation didn’t suffer, but we spent countless hours defending ourselves when in fact we have a very strong track record in environmental stewardship.

What was the low point after your return?

The challenge was how to preserve and enhance the integrity of the only assets we have as a company: our values, our culture and guiding principles, and the reservoir of trust with our people. There was unbelievable pressure from multiple constituents. I’ve saved every analyst’s report and major story, and what was said about us and about me. My favorite was “Never give an 800-pound gorilla caffeine.” There was a death march of comments like “Starbucks’s days are numbered,” “It’s no longer relevant,” “McDonald’s will definitely kill Starbucks,” and “How could the board bring back Schultz, who is responsible for all this?”

How had things gone so wrong?

There was a different team here—very good people, who deserve respect and not the burden of responsibility, because I was chairman of the company, and I am culpable. Success is not sustainable if it is defined by how big you become or by growth for growth’s sake. Success is very shallow if it doesn’t have emotional meaning. I think there was a herd mentality—a rea-

son for being that somehow became linked to PE, the stock price, and a group of people who felt they were invincible. Starbucks isn’t the first company that has happened to, and thankfully we caught it in time.

Do you feel there’s a clash between trying to be a premium destination with a premium-priced product and being a public company?

I don’t think so. Hundreds of public companies have a premium position in their categories. I think the tension is about can you be big and stay “small”? Can you maintain intimacy with your customers and your people? We understand our business very well, and we understand our customers. And to a person, we understand that we are only as good as yesterday and we have to come to work every day and try to exceed the expectations of our people and customers.

Yet every company that begins small and “authentic” eventually finds it hard to retain that image as it expands. How can you combat that?

You have to have a 100% belief in your core reason for being. There was tremendous pressure in the first three or four months after my return to dramatically change the strategy and the business model of the company. The marketplace was saying, “Starbucks needs to undo all these company-owned stores and franchise the system.” That would have given us a war chest of cash and significantly increased return on capital. It’s a good argument economically. It’s a good argument for shareholder value. But it would have fractured the culture of the company. You can’t get out of this by trying to navigate with a different road map, one that isn’t true to yourself. You have to be authentic, you have to be true, and you have to believe in your heart that this is going to work. Someone said to me, “You are roasting 400 million pounds of coffee a year. If you reduce the quality 5%, no one would know. That’s a few hundred million dollars!” We would never do that.

How did you start to get things back on track? To what extent was it an advantage that you had been in the CEO chair before?

There were a number of things I did that perhaps a new CEO couldn’t have done because he wouldn’t have had the license I had. For example, I shut our stores for three and a half hours

of retraining. People said, “How much is that going to cost?” I had shareholders calling me and saying, “Are you out of your mind?” I said, “I’m doing the right thing. We are retraining our people because we have forgotten what we stand for, and that is the pursuit of an unequivocal, absolute commitment to quality.”

What has been your big leadership moment since you came back?

I decided—against the advice of many people at the time, because it had a high cost attached to it—to take 10,000 store managers to New Orleans. I knew that if I could remind people of our character and values, we could make a difference. The conference was about galvanizing the entire leadership of the company—being vulnerable and transparent with our employees about how desperate the situation was, and how we had to understand that everyone must be personally accountable and responsible for the outcome of every single customer interaction. We started the conference with community service. Our efforts represent the single largest block of community support in the history of New Orleans, contributing more than 54,000 volunteer hours and investing more than \$1 million in local projects like painting, landscaping, and building playgrounds. Projects took place in several New Orleans neighborhoods over the course of the week, and I personally assisted with the restoration of homes in one of the hardest-hit areas of the city.

If we hadn’t had New Orleans, we wouldn’t have turned things around. It was real, it was truthful, and it was about leadership. An outside CEO would have come into Starbucks and invariably done what was most expected, which was cut the thing to the bone. We didn’t do that. Now, we did cut \$581 million of costs out of the company. The cuts targeted all areas of the business, from supply chain efficiencies to waste reduction and rightsizing our support structure. But 99% were not consumer-facing, and in fact, our customer satisfaction scores began to rise at this time and have continued to reach unprecedented levels. We reinvested in our people, we reinvested in innovation, and we reinvested in the values of the company.

To what extent do you feel a clash between being the person you want to be, with the values you have, and the responsibilities of running a big public company?

That’s a very important question. Being the CEO of a public company over the past couple of years has been difficult. And lonely. The tension you describe assumes that one can’t be values-driven or values-based and achieve success or the respect of the Street. I don’t think that is true. But the only ingredient that works in this environment is performance—so we have to perform. If we don’t perform, either we have the wrong strategy or we don’t deserve to be here. I think we’ve demonstrated that the strategy is right and the balance between profitability and having a social conscience and being a benevolent company will lead to significant long-term value for shareholders.

What’s an example of a decision you’ve made that Wall Street didn’t like?

Health care. Our health care costs over the past 12 months were approximately \$300 million. [Starbucks offers health care benefits to any eligible employee who works at least 20 hours a week.] The thought that we would cut that benefit—I couldn’t do it. Within this past year I got a call from one of our institutional shareholders. He said, “You’ve never had more cover to cut health care than you do now. No one will criticize you.” And I just said, “I could cut \$300 million out of a lot of things, but do you want to kill the company, and kill the trust in what this company stands for? There is no way I will do it, and if that is what you want us to do, you should sell your stock.” What I stand for is not just to make money; it’s to preserve the integrity of what we have built for 39 years—to look in the mirror and feel like I’ve done something that has meaning and relevancy and is something people are going to respect. You have to be willing to fight for what you believe in.

How do you ultimately define shareholder value?

I do not believe that shareholder value is sustainable if you are not creating value for the people who are doing the work and then value for customers. Quintessentially we are a people-based company. You couldn’t find another consumer brand that is as dependent on human behavior as we are. We built Starbucks not through traditional marketing or advertising but through the experience. And that experience can come to life only if people are proud, if they respect and trust the green apron and the people they are representing.

“Quintessentially we are a people-based company. You couldn’t find another consumer brand as dependent on human behavior.”

“We got nailed for instant coffee because people thought it was the most desperate thing we could be doing. But it’s going to be a major business for the company.”

To what extent did the cuts and layoffs you made break the internal trust that you had built up?

There are a lot of ways you can communicate bad news. We decided that we had to be in front of our people, so we held a companywide meeting with me at the center to announce the layoffs and closures. We had an open mike, and people went after me. I stood there and answered the questions, and I apologized for making decisions that people thought fractured the trust we had built for so many years. I tried to explain that these decisions were made on the basis of preserving the whole, and that I understood there would be damage. I also explained that we felt incredible compassion for the people who had to leave. You have to be honest and authentic and not hide. I think the leader today has to demonstrate both transparency and vulnerability, and with that comes truthfulness and humility and obviously the ability to instill confidence in people, and not through some top-down hierarchical approach.

You talk a lot about values. How do you balance these with more-standard strategic thinking?

Unfortunately, we live in a sea of mediocrity in all walks of life. We also live amid a fracturing of civility. Everywhere we go as consumers, we’re getting people who don’t want to reach into our hearts or know who we are; they want to reach into our wallets and get some money. The equity of the brand is defined by the quality of the coffee but also, most importantly, by the relationship that the barista has with the customer and whether or not the customer feels valued, appreciated, and respected. That is our aspiration every day. The reputation of the company is the reason we can put bottled Frappuccino on a supermarket shelf, or VIA [instant coffee], because there is a level of trust and confidence in the brand name. The only way we can succeed and sustain growth and innovation is linked to the basic elements of one cup of coffee, one customer, and one barista at a time.

You obviously are a very emotional guy and put a lot of stock into your relationship with your staff. To what extent are you a metrics guy?

I think I am an intuitive person to a fault. Over the past year and a half I have become more reliant on what you call the metrics, but that

has never been a primary guide for me. More often than not I’ve taken the road less traveled. We got nailed for instant coffee because people thought it was the most desperate thing we could be doing. The research said it could be brand dilutive, that no one would pay a dollar for a cup of instant coffee, that it would cannibalize our sales. But it’s going to be a major business for the company, and people will look back and say, “Boy, they were smart.” VIA continues to exceed our expectations in every market where we’ve launched, and we remain extremely excited about its prospects as we add new markets during the coming year. We expect a positive contribution to profit for the full fiscal year 2010 based on the strong performance of VIA to date.

How do you execute your vision and strategy?

Whether you are a high-tech company or a coffee company, your responsibility has to be to constantly create the kind of excitement that provides differentiation and separation in the marketplace. Not innovation for innovation’s sake but innovation that is relevant, usable, and, in our case, core to the culture. In terms of execution, we’ve unplugged a lot of things that were taking up mind space and time, and we’ve understood that less would be more. Innovation is a way of life for us, but we put every new idea through a tremendous amount of scrutiny: Is this what our customers want? Can we scale it? Can this help us provide an even better experience for our customers? We were asking our people to do too much, to chase after too many new ideas that took us away from our core business, so we pulled the plug on lots of things and focused on the ones that were most important.

Let’s talk more about the role of social media. There are people out there who adore you, and people who criticize everything you do. How do you take advantage of the new tools?

The rules of engagement in traditional marketing are over. Whether you are creating a brand, building one, or running a big one, you’d better understand social media, because there is a seismic shift in how people are gaining access to information and, as a result, how they are behaving. Information can’t be from the company to the consumer; it has to be a level playing field where consumers feel that they are opting in and that there is a sharing of information.

Cracking the code involves understanding how to create an opportunity for people to feel pride, a sense of discovery, that they want to share this with someone they care about.

How, exactly, do you reach out?

The dipper well was a lesson. We assembled a group of very smart people who understand the world I just described and live it every day. And we created not a tool kit but a new way of behaving, of being proactive and creating ways in which we could connect the dots through a landscape of multiple digital media and social media channels and could become a relevant, trusted source rather than a promoter of a product or ideas. With help, we set up a website to seek ideas from customers. There was great resistance inside to allowing the outside world to tell us what we are doing wrong. But the openness led to a different mentality. We weren't myopic about who we were and how we were going to go to market. We became more open and vulnerable, listened to people, and as a result started creating a new methodology, a new language, and new tools and tactics that enabled us to become best of class. We're the number one brand on Facebook.

What does that get you?

It means that 7 million people are very interested in what we are doing and what we have to say. It has changed our go-to-market strategy—how we communicate, unveil, and innovate, and ultimately how we arrive in the marketplace. The success of the things we have done this year is directly linked to the fact that the cost of customer acquisition and communicating to the outside world is significantly lower for us than it is for people who are spending money on traditional advertising or haven't got this right. The feedback loop is making us better because of the insight we are gaining from that audience. We never were a traditional advertiser, and our marketing dollars were typically spent in the store, because our baristas and word of mouth built that brand. While that's still the case today, social media now give us another way to connect to customers.

Well, your numbers do seem to be starting to turn around.

The numbers don't tell the whole story, but Q1 represented the best financial results in the history of the company, and Q2 was the first time

in 13 quarters that we've had incremental traffic in our stores.

Now what? Is the café business played out? If so, where will you find future growth?

I dispute that the relevancy of a Starbucks retail store or café doesn't have staying power. I would say the opposite. We are living in a society where there is a need for human connection and a sense of community. And what we do every day is bring people together. Last week I was in four Asian countries in six days. In all four places there is a mirror image of what happens in a Starbucks store in Seattle—the sense of community extension. People are using Starbucks stores as their own, and drinking coffee. So the growth of the company is going to come from continuing to optimize the retail footprint. We're not nearly close to saturation in North America, despite what the cynics or pundits might say, and certainly the runway for growth outside North America is significant. We have less than a 1% share of coffee consumption outside North America.

What are your plans for new sources of growth?

In the past 10 years we've created a unique combination of assets. We own our retail stores and also have been able to leverage the Starbucks brand to bring products to the grocery channel. The best case study of that is Frappuccino, which is now a \$2 billion revenue business. Most national retailers franchise their businesses, which limits distribution opportunities outside their retail stores. Our differentiated model—added to the culture and values that define our company—gives us the nimbleness and flexibility to offer our products to customers through multiple channels. We're now selling VIA through this model, at 30,000 distribution points. Instant coffee is a \$23 billion global category that hasn't seen much innovation in years. Most of it is low-grade. We've cracked the technological code and can deliver with VIA the same Starbucks coffee quality.

How big can you be in China?

We will have thousands of stores in China. Chinese people are drinking Starbucks coffee and using our stores as an extension of their home or work. China is an extremely complicated place to build a relevant consumer brand that doesn't become faddish and out of favor. It's

“China is an extremely complicated place to build a relevant consumer brand. We will get it right.”

filled with a lot of navigational challenges. Every consumer brand in the world is looking at China as the answer to its prayers. There will be lots of winners, and there will be many, many more losers who don't get it right. We will get it right. We have to be thoughtful, highly disciplined, and extremely respectful of local Chinese customs, food preferences, and consumer behavior. In order to do that, we have to see the world through a Chinese lens. We are really turning upside down the go-to-market strategy whereby things in the past few years have been invented and executed here. They now have to be invented and executed by the local Chinese team. The challenge is making sure that we do it within the guardrails of the Starbucks brand.

Like Steve Jobs, you were a seminal leader. And when you handed over the reins, there was trouble. Can you ever leave again? Would Wall Street panic?

It's a fair question. I've talked to friends who founded companies about this issue and the role of a founder, and what it means when at some point you do leave. One of the lessons learned is about succession planning. In all fairness to Jim Donald [the CEO from 2005 to January 2008], I don't think I did that well. And as self-serving as it sounds, I don't think an outsider would have succeeded [as CEO]. The ground was crumbling underneath us because of self-induced issues, the financial climate, and seismic changes in consumer behavior. I knew where all the bones were buried, so I could move quickly. An outsider would not have had the time to learn. As a result, he would have yielded to the easy place to go, which would be cuts, and that would have taken all the heart and soul and conscience out of the company. I

am very aware of my duty and responsibility to get succession planning right the next time around. But I am here to see this through for a while. I'm not leaving soon.

What will the Howard Schultz career legacy ultimately be?

There is a sensibility of the brand. Our role as leaders is to celebrate the human connection that we have been able to create as a company, and to make sure people realize the deep level of respect we have for the work they do and how they act. That is the legacy of the company. It's not to get bigger or to make more money.

Here's a true example: A woman barista in Tacoma, Washington, sees a customer every day, and they become friendly as a result of her work. She begins to see that the woman looks ill. Finally she gets up the courage to say, "You just don't look well—what's wrong?" The woman says, "If I don't get a kidney transplant, I am going to die." A miracle occurs: The barista is a match for the customer, and she gives her a kidney. It's incredible. I drove to Tacoma to see her, and I said, "Who are you? I've never heard a story like this." There are a lot of really great companies out there, and wonderful cultures, but something like this doesn't happen very often.

You've probably been asked this a million times, but what's your drink?

My favorite coffee is aged Sumatra. My typical drink is a doppio espresso macchiato.*

*A double espresso topped with steamed milk.

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