

## **Star Gazer Howard Schultz, CEO of Starbucks**

When Schultz's company, Il Giornale, bought Starbucks and changed the chain name to Starbucks Corp. in 1987, there were only 17 stores; today Starbucks serves nearly 20 million people a week from almost 5,000 outlets. Under Howard's tenure, the Seattle company has notched 121 consecutive months of positive comp sales--a key industry measure--since it went public in 1992.

[start box] When I look back to the earliest part of the growth and development of the company, there was a constant theme that we had then, that we have today and it was linked to consistently investing ahead of the growth curve in almost every discipline. From the earliest days, we saw ourselves bigger and broader than a local company in Seattle. That's not to say we ever imagined there would be 11,000 stores all over the world, but we saw and dreamed and had the vision to build a bigger company. We had our sights on the needs and the requirements to accomplish that whether it was systems, infrastructure, obviously people, manufacturing, all these things that lead us to hire and invest ahead of the growth curve. If you are not investing ahead of the growth curve, that is going to catch up to you.

We were in the business of really building the equity of the brand from within. That meant the culture, the values and the guiding principles of how we were going to build the company was going to be the way we communicated the essence of the Starbucks experience first to our people and then to our customers. We said early on that we wanted to exceed the expectations of our customers but in order to do that we also recognized we had to exceed the expectations of our people first. One of the ongoing reasons that Starbucks has such a strong foundation of trust with our customers is because we have built an emotional relationship around human connection with both our people and our customers and that has defined the brand. The fact that we are in the coffee business, and that it's such a social and romantic beverage has given us the platform to create a sense of community and a whole genre around humanity in our business and in the company and we have been able to do that around the world.

As employees, we want to be valued and respected and as customers we want to walk into a place that feels safe and that is not trying to get money out of our pockets but is trying to touch our hearts and give us something back and so that has given us the runway to expand the company well beyond what we ever thought.

It is true that I was asked if I was starting a business today, who would I hire first, and I said head of Human Resources. I think that in most growth companies people recognize almost too late that the most important function in a company is human resources and they get to that too late because they are hiring for sales or marketing or finance or whatever. I would invert that model and say that HR has to be right at the beginning of the core competency at the very highest level and then over time you have to make sure the HR function, the HR discipline, not only has a seat at both the leadership table of the company and the boardroom but that seat is valued and respected and those opinions are going to be heard. When I think back about why we have succeeded almost without hesitation, it's because we have been able to attract and retain great people. We've almost always been able to attract the right person at the right time and I think it's because we've invested so heavily in that function and have put it in a position to always be at the leadership table of the company ahead of the growth. I sit back today looking at what we're doing in China. We're replicating that exact same model now in China where we have made and continue to make significant investments in China well, well ahead of what the business is today. We couldn't succeed at the level we are dreaming about unless we were going to do that as we did in the U.S.

I don't think there's one formula for success but I think there are consistent aspects that are true in most enduring brands. I hate to use words that have been used before, but there has to be great authenticity and truth to the story. Building a brand on the foundation of a 30 second or 60 second Super Bowl commercial without any substance, is not going to work -- it's more noise. In today's world, in one way this is much more difficult than ever before, but in another way it's easier because there aren't many companies that stand for these things because they are looking for the short term results and the short term solution and there is none. When I think about the great brands of today, if you think about what Apple has done and the iPod and what it represents, the emotional engagement that that device has to the customer, if you think about Nike, Ikea, Google, these are companies whose products transcends the experience the customer is having. It's much more meaningful than just the experience, it goes beyond that and they have a level of emotional engagement from the customer that is very, very different than say buying a box of Tide.

Whether you read Friedman's book "The World is Flat" or you pick up any business or consumer newspaper or anything you can't escape the fact that Asia and China are going to be at the center of the world. What's going on in India or Russia, in all of these countries, speaks to the fact that the internet in many ways has been the death of distance. I don't look at customers or markets as where they live or what country they're in, I look at one marketplace. Now I realize that in order to succeed in these multiple market places you have to be as relevant and as local as possible but I think you have to start from the beginning seeing that the marketplace and the opportunities are well beyond the borders of the U.S. We did go to Japan probably earlier than we had the capacity to do so. We learned as we went, we made some mistakes but if we didn't do that we wouldn't be in a position to have 1) we have over 3,000 stores in 37 countries now and we never would be in a position to take advantage of the opportunity in China. You want to balance going after new opportunities without sacrificing the core, but you have to dream big and be able to seize opportunities and sometimes you're not prepared for it.

Growth can be intoxicating and very seductive and you have to make sure that someone is looking in the rearview mirror because it does cover mistakes and you have to keep looking back as well as forward. Great retailers are very adept at preserving the core business while enhancing the experience and when I think about that, whether it's what we've done around music, the Starbucks card, the WiFi network that we've done, all of these things that have enhanced the experience but have been very complimentary to the core coffee business and core experience. I think that as a retailer and as a merchant you want to make sure that you aren't doing anything that would in any way dilute the integrity of why people come in. In terms of the corporate aspect of growing the company, I think if I've learned one thing over the years is you have to make sure that you're not chasing too many rabbits and that the core business is really the foundation of what you do and that you don't go off half cocked and constantly be seduced by every opportunity that comes in the door because most growth companies are consistently going to have more opportunities than they have capacity. The road is paved with so many companies that have done so well along the way but then they embrace some level of arrogance and they start doing things that over time either erode the equity of the brand, trust with the customer or in some cases are fatal to the company's ability to sustain itself.

I think many companies become paranoid about competitors and what competitors are doing and that takes them in directions in which they are trying to offset competitive pressure. Another thing we have learned over the years is that the best competitive defense we have is what we do as a company in our stores with our people and obviously by creating wonderful moments with our customers.

Like everyone else in the world, I am amazed and stunned with what is going on in China. I'm spending a week every quarter in China. Having said that, I want to share with you that I think a lot of people are going into China perhaps the way they went to the gold rush. There's going to be people, not unlike the internet, where there's going to be a burst and people are going to fail.

The whole area of wellness is an area that I am very intrigued by personally I think because I've spent so much time in Asia over the past 2 years, a lot of the medicinal products and medicines that have come out of China and Asia are interesting to me.

There's going to be a new evolution of retail players that create spaces of comfort for people. One of the things Starbucks has benefited from significantly has been the fact that we have not only become the third place, but more than that the environment has become as important as the coffee itself. Retailers and merchants that create environments for people to enjoy themselves as well as the merchants trying to sell products are going to win, not enough people I think have figured that out. The adoption rate of things fascinates me. I think that's another dynamic. It took us 20 plus years to build the Starbucks brand. When things are positioned properly in today's environment because of quickly and freely information flows there's an unbelievable rate of adoption that is dynamically quicker and stronger than in years past. Even though Starbucks is in the coffee business and the bricks and mortar business, no business today can ignore the way in which your customers are acting during the day outside of your stores. You have to be a chameleon and really get underneath all this so that you maintain your relevancy." [end box]

Another example of how groupthink infects thoughtful evaluation is in portfolio diversification. A group generally considers it less risky to own a broad, diverse portfolio, than to own a relative handful of stocks which are followed closely and whose business and fundamentals are fully understood. Ironically, investors that tend to under-perform the market do as the group does to avoid having all their eggs in one

basket. Investors that demonstrate superior performance over time however, maintain portfolios that are more concentrated, watching each egg very closely.

*It should be no mystery that no great work of art, recipe or music was ever created by a group.* Similarly, we are not aware of any great investment track record that has been created by a committee. Any manager who is truly trying to anticipate future economic trends is bound to take positions that are wildly at variance with what is popular in the market, and this behavior will appear eccentric and ill-informed in comparison to the current market favorites.

Thoughtfully zigging when others zag is often the key to success on Wall Street. Blindly going against conventional wisdom isn't any brighter than mindlessly embracing popular opinion, however. In other words, success in growth investing requires an intent focus on the drivers of growth and steadfast objectivity even when this means running against the grain of the consensus. As an example, many growth investors are known as "growth mavericks", or in more difficult investment environments, "fair weather" outperformers; racking up disproportionate gains when the economic and market environment are moving higher, and having a difficult time "rotating" when the weather turns ugly.

There is always a growth market somewhere. At any given time, however, the willingness to adapt to where the growth is "now" is a discipline that is difficult to stick to.