STANFORD
GRADUATE SCHOOL OF BUSINESS

GLOBAL SUPPLY CHAIN MANAGEMENT FORUM

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# STARBUCKS CORPORATION
## BUILDING A SUSTAINABLE SUPPLY CHAIN

*Over the last several years, Starbucks has instituted a new purchasing philosophy. We have done this because it is the right thing to do – for farmers, for our people, and for our business. Because we have persuaded our customers to pay high prices for quality roasted coffee, we are able to pay high prices for green unroasted coffee. We also believe that the high prices we pay for coffee allow us to be a potential force for positive reform in every part of our supply chain.*

—Orin Smith, Former President and CEO; and Dub Hay, SVP, Coffee, Starbucks Corporation[1]

Starbucks Corporation was the world's largest specialty coffee retailer, with $6.4 billion in annual revenue for the fiscal year ended October 2, 2005. The company continued to expand the number of retail stores worldwide, and consistently saw strong growth in the sales and net profits (see **Exhibits 1** and **2**). Since going public in 1992, its stock appreciated more than 4,000 percent after adjusting for stock splits.

In the 1990s, the specialty coffee industry experienced gigantic growth, fueled largely by the coffee-drinking habits of college graduates and other educated professionals. In the previous few years, however, a worldwide oversupply of lower-grade coffee had depressed the world's market prices, making it difficult for coffee farmers to earn enough revenue to cover the cost of production. Although Starbucks only purchased the highest quality Arabica coffee and paid premium prices, all farmers suffered from the oversupply of coffee (see **Exhibit 3**).

[1] This case is based on interviews with the following Starbucks representatives: Dub Hay, Vice President of Coffee Procurement; Brooke Brown, Project Specialist, Coffee; Stephane Erard; and Michelle Richardson. All subsequent quotes and references are from these interviews or information provided by Starbucks unless otherwise noted.

Stacy Duda, LaShawn James, Zeryn Mackwani, Raul Munoz, and David Volk prepared this case under the supervision of Professor Hau Lee as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

By the end of 2005, Starbucks was at a challenging point in its history. It boasted more than 10,000 stores—up from 676 a decade before—and roasted 2.3 percent of the world's coffee. Each day it opened an average of four stores and hired 200 employees. To support such a high growth rate, it was clear that an integral part of the company's future success would come from meeting increased demand through a secure supply of high-quality coffee beans. Coffee beans constituted the bread and butter of Starbucks' business—the company had to ensure a sustainable supply of this key commodity. Consequently, Starbucks partnered with Conservation International, an environmental nonprofit organization, to develop C.A.F.E. Practices (Coffee and Farmer Equity Practices). C.A.F.E.'s goals were to contribute to the livelihood of coffee farmers and to ensure high-quality coffee for the long term. This initiative was based on three principles: (1) a sustainable supply of high quality coffee beans, provided by a stable source of coffee farms with farmers who were not exploited by their trading partners, (2) lands farmed with environmentally sound methods, and (3) families that live in healthy, secure and supportive societies. Such farmers would be more inclined and able to invest in productivity improvement tools and activities, and in their communities, thereby promoting a source of stable and sustainable coffee supply.

## COMPANY BACKGROUND

Starbucks was founded in 1971 when three academics—English teacher Jerry Baldwin, history teacher Zev Siegel, and writer Gordon Bowker—opened a store called "Starbucks Coffee, Tea, and Spice" in Seattle. The partners named the company in honor of Starbuck, the coffee-loving first mate in Herman Melville's Moby Dick. The company's logo is a two-tailed mermaid encircled by the store's name.

By the early 1980s, the company had four Starbucks stores in the Seattle area and had showed profitability every year since opening. However, the roles of the founders underwent major changes. Zev Siegel left the company, Jerry Baldwin took over day-to-day management and functioned as CEO, and Gordon Bowker remained involved as owner while devoting most of his time to other business ventures.

In 1982, Baldwin recruited Howard Schultz, vice president and general manager of U.S. operations for Hammarplast, a Swedish maker of stylish kitchen equipment and housewares, as head marketing and retail stores supervisor. Schultz's biggest idea for the future of Starbucks came during the spring of 1983 when the company sent him to Milan, Italy, to attend an international housewares show. While walking from his hotel to the convention center, Schultz spotted an espresso bar and went inside to look around. The cashier beside the door nodded and smiled. The barista (counter worker) greeted Howard cheerfully, then gracefully pulled a shot of espresso for one customer and handcrafted a foamy cappuccino for another, all the while conversing merrily with those standing at the counter. On Schultz's return from Italy, he shared his revelation and ideas for modifying the format of Starbucks stores with Baldwin and Bowker. But instead of winning their approval, Schultz encountered strong resistance. After many failed efforts trying to persuade Baldwin and Bowker, Schultz decided to leave Starbucks and planned to open espresso bars in high-traffic downtown locations that would emulate the friendly, energetic atmosphere he had encountered in Italy. Schultz left Starbucks in late 1985 to open his first Il Giornale store a year later.

In March 1987, Jerry Baldwin and Gordon Bowker decided to sell the whole Starbucks operation in Seattle—the stores, the roasting plant, and the Starbucks name. Schultz raised capital and immediately bought the company. The new name of the combined companies was Starbucks Corporation. Howard Schultz, at the age of 34, became Starbucks' president and CEO.

In 2005, Starbucks had more than 10,200 company operated & licensed stores in more than 35 countries. The stores offered coffee drinks and food items, as well as beans, coffee accessories, teas, and music. Starbucks operated more than 5,200 stores in ten countries (80 percent in the U.S.), while licensees operated more than 2,800 units in 28 countries. U.S. licensed stores were located primarily in shopping centers and airports. The company also owned and licensed the Seattle's Best Coffee and Torrefazione Italia chains in the U.S. (more than 100 shops). In addition, Starbucks marketed its coffee through grocery stores and licensed its brand for other food and beverage products.

## The Specialty Coffee Industry and the Starbucks Coffee Supply Chain

Since the 1980s and especially in the 1990s, the specialty coffee industry grew dramatically. Many experts felt that the differentiated coffees supported by the specialty industry would continue to expand at a much faster rate than conventional coffees. However, the definition of specialty in the United States continued to be refined. By 2005, it included coffees that were not necessarily high quality and were otherwise only distinguished by being flavored (e.g., chocolate, cinnamon, and hazelnut, etc.) and served as an espresso or milk-based beverage. The industry began to redefine "specialty" to reflect more of a quality orientation (see **Exhibit 4**). Also called "gourmet" or "premium" coffee, specialty coffee was made from exceptional beans grown only in ideal coffee-producing climates. It tended to feature distinctive flavors, shaped by the unique characteristics of the soil in which it was grown. Specialty coffee became one of the fastest growing food service markets in the world. The percentage of adults in the U.S. that consumed specialty coffee daily increased from 9 percent in 2000 to 16 percent in 2004, and 56 percent of adults claimed to be occasional consumers. The total specialty coffee market was estimated to be $9.62 billion in 2004.[2]

In 2004, there were an estimated 18,600 specialty coffee outlets in the United States.[3] Starbucks' success had prompted a number of ambitious rivals to scale up their expansion plans. Observers believed there was room in the category for at least two or three other national players. (See **Exhibit 5** for Starbucks' key competitors.)

Coffee beans could come from all over the world—about 50 percent came from Latin America, 35 percent from the Pacific Rim, and 15 percent from East Africa. Most of the coffee producers were small to medium-sized family-owned farms. Some farms were able to process their coffee beans, but most sold their outputs to processors through local markets (mills, exporters or co-operatives). The processors turned coffee "cherry" into parchment or green coffee, and then sold it to suppliers who were exporters or distributors. These suppliers provided many services to

[2] "Specialty Coffee Retail in the USA 2005," Specialty Coffee Association of America, https://www.scaa.org/pdfs/news/specialtycoffeeretail.pdf (February 5, 2007).
[3] Ibid.

processors and farmers, such as marketing, dry milling, technical coffee expertise, financing, and export logistics.

Starbucks also purchased coffee through agents from individual estates and producer associations in addition to suppliers, or directly from the processors. **(Exhibit 6** gives a simplified picture of the supply chain of green coffee to Starbucks.)

## C.A.F.E. PRACTICES

Despite its domination of the specialty coffee industry, Starbucks did not use its purchasing power as a way to squeeze its coffee suppliers in order to improve margins. Instead, the company decided to use its market power as a way to implement social change within its supply chain through C.A.F.E. Practices. C.A.F.E. Practices was a way for Starbucks to ensure a sustainable supply of high quality coffee beans, which was an essential component of Starbucks' business. The initiative built mutually beneficial relationships with coffee farmers and their communities. It also helped to counteract the oversupply of low-grade coffee on the world's market, which suppressed prices making it difficult for farmers to cover the cost of production. When Starbucks implemented C.A.F.E. Practices, it had six objectives in mind:

1. Increase economic, social, and environmental sustainability in the specialty coffee industry, including conservation of biodiversity.
2. Encourage Starbucks suppliers to implement C.A.F.E. Practices through economic incentives and preferential buying status.
3. Purchase the majority of Starbucks coffee under C.A.F.E. Practices guidelines by 2007.
4. Negotiate mutually beneficial long-term contracts with suppliers to support Starbucks growth.
5. Build mutually beneficial and increasingly direct relationships with suppliers.
6. Promote transparency and economic fairness within the coffee supply chain.

C.A.F.E. Practices was a set of coffee buying guidelines designed to support coffee buyers and coffee farmers, ensure high quality coffee and promote equitable relationships with farmers, workers, and communities, as well as to protect the environment (see **Exhibit 7**). It was not a code of conduct or a compliance program. Instead, it was a way of doing business that was aimed at ensuring sustainability and fairness in the coffee supply chain. This sustainability and fairness was achieved through a set of global guidelines for Starbucks suppliers and a set of incentives to reward farmers and suppliers who followed those guidelines. The guidelines consisted first of a set of prerequisites, which had to be met in order to be considered for the C.A.F.E. Practices initiative. These prerequisites set a minimum standard for Starbucks suppliers, including coffee quality and economic transparency. The transparency prerequisite meant that suppliers were expected to illustrate economic transparency on the amount of money that was ultimately paid to farmers.

After the initial prerequisites had been met, suppliers were graded based on a set of environmental and social criteria. All suppliers were evaluated not just on their performance, but also on their supply networks of farms. Farmers were rewarded for coffee growing and processing practices that contributed positively to the conservation of soil, water, energy, and biological diversity, and had minimal impact on the environment. Also, C.A.F.E. Practices encouraged farmers and others to make sure that workers' wages met or exceeded the minimum requirements under local and national laws. Effective measures were required to ensure workers' health and safety and provide them with adequate living conditions. Based on their performance, as measured against the environmental and social criteria, suppliers might earn up to 100 percentage points in C.A.F.E. Practices.

Under C.A.F.E. Practices, farms, mills, and suppliers had to illustrate equitable payments to those who worked for them or sold to them. They had to demonstrate economic accountability and document their hiring and employment practices. Scores were audited by an independent verifier, and licensed by Scientific Certification Systems, a third-party certification company that provided independent analysis and certification of a wide range of environment sustainability and food safety achievements.[4] Since the verifier was independent of Starbucks, the cost of the verification had to be negotiated between the supplier and the verifier. However, there was no cost to the supplier to submit a C.A.F.E. Practices application to Starbucks.

In order to qualify for C.A.F.E. Practices supplier status, suppliers had to be independently verified and meet minimum Social Responsibility criteria. Points above 60 percent increased the status of the supplier. For scores above 60 percent, the supplier qualified as a Preferred supplier and would gain preference in future Starbucks coffee purchases. Additionally, suppliers who earned scores above 80 percent would qualify as Strategic suppliers and would earn a Sustainability Conversion Premium of $0.05 per pound of coffee for one year.[5] In order to encourage continued improvement, Starbucks also offered an additional Sustainability Performance Premium of $0.05 per pound of coffee to suppliers who were able to achieve a 10-point increase above 80 percent over the course of a year.

Besides the price premium for Strategic Suppliers, C.A.F.E. Practices allowed Starbucks to buy from preferred suppliers first, paying high prices and offering preferential contract terms to those with the highest scores. The premium prices helped coffee farmers make profits and support their families, despite a global glut in the coffee bean industry. Additionally, Starbucks provided access to affordable credit to coffee farmers through various loan funds. They invested in social development in coffee producing countries and collaborated with farmers through the Farmer Support Center in Costa Rica to provide technical support and training. If a supplier failed to meet C.A.F.E. Practices criteria, Starbucks sponsored information sessions in coffee growing regions for farmers. (See **Exhibit 8** for a description of a farmer benefiting from the C.A.F.E. Practices program.)

## BENEFITS TO STARBUCKS

Even though the direct benefits of C.A.F.E. Practices helped suppliers and farmers, Starbucks received significant indirect benefits from the program. The program strengthened Starbucks' supply base, improved its marketing ability, and increased its visibility into the supply chain.

[4] "About SCS," Scientific Certification Systems, http://www.scscertified.org/about.html (March 1, 2007).

[5] On average, Starbucks paid about $1.20 per pound of coffee. "Starbucks - Corporate Social Responsibility Report, FY04," Starbucks Corporation, p. 15.

Therefore, the benefits of C.A.F.E. Practices extended all the way through the supply chain, from the farm to the end consumer.

**Supply Base**

On the supply base side, the program served to lock in strategic and high quality suppliers. This consistent, quality supply could provide Starbucks with a competitive advantage over other coffee roasters in the industry. Since suppliers would have invested resources in complying with Starbucks programs, they would have an incentive to remain with Starbucks and would face switching costs should they try to demonstrate their excellence to another coffee roaster. The large pool of high quality suppliers would also smooth supply fluctuations by providing a base supply of high quality growers. Since Starbucks' long purchase cycle included signing purchase agreements before the crop had even been harvested, any reduction in supply uncertainties and fluctuations could lead to better planning of future supply in the form of faster procurement. C.A.F.E. Practices could also improve Starbucks' reputation among suppliers, which would make it easier to expand into purchasing in different countries or locations.

In the long run, C.A.F.E. Practices also sought to buffer against a form of bullwhip effect that existed in the coffee industry supply chain. As coffee sales increased during the 1990s with the growth of Starbucks and the specialty coffee industry, suppliers and farmers began to respond with a huge increase in the amount of land dedicated to coffee farming. The resulting glut of coffee beans on the market led to decreased prices and a shortage of high quality coffee. Such fluctuations in price and supply were common in commodity products that faced very long supply response times. In order to combat price and supply volatility, the C.A.F.E. Practices initiative induced longer-term supply relationships with a consistent set of suppliers. Starbucks was hopeful that this program would reduce its susceptibility to price and supply volatility in the global coffee market.

**Marketing**

On the marketing side, C.A.F.E. Practices supported Starbucks' socially responsible goals. While C.A.F.E. Practices were not yet widespread and were not directly marketed to customers, an increased awareness of Starbucks corporate social responsibility (CSR) practices could help justify Starbucks' premium prices. C.A.F.E. Practices would allow Starbucks to market its coffee as procured through a highly selective process that ensured only the highest quality beans. Awareness of this program might encourage other coffee roasters to join in the C.A.F.E. Practices program; however, Starbucks would be known as the inventor of the program. They might also be able to brand their practices and sell the know-how to other roasters that were looking to implement similar initiatives. Such widespread expansion of the program would simply serve to extend its benefits towards creating a base of high quality coffee beans. With each improvement in the supply of beans, Starbucks achieved more flexibility in being able to charge premium prices at its stores. C.A.F.E. Practices also improved employee morale by creating an atmosphere of social responsibility that they could be proud of.

## Supply Chain Visibility

Finally, C.A.F.E. Practices increased the visibility of Starbucks' supply chain by demanding documented and verified product and financial flows through its suppliers' supply chains. In the past, Starbucks had very poor visibility into their supply base, as coffee farmers and processors were not very technologically sophisticated or mature in their business processes. By increasing the transparency of their supply base, Starbucks would be able to gain a better understanding of the needs and the conditions of their suppliers. The increased visibility would also allow Starbucks to improve its relationships with growers, who before had been isolated from them due to intermediaries—coffee exporters and distributors—that came between the two sides.

On a more practical note, increased visibility in the supply chain could allow Starbucks to better predict supply shortages as they arose. Since the majority of Starbucks coffee was grown in developing countries in Latin America, Africa, South America, and Southeast Asia, Starbucks had a significant risk of supply shortage due to regional instability. Without visibility into the supply base, Starbucks did not have a good way to predict the impact of regional instability to its coffee supply. With increased visibility, an outbreak of regional instability could be linked to a particular quantity of expected coffee supply, giving Starbucks advance notice of the need to find alternate sources of coffee. This could allow Starbucks to be proactive in managing supply disruptions even before they arose.

## CORPORATE SOCIAL RESPONSIBILITY

Starbucks provided various resources to promote and help farmers comply with the guidelines of C.A.F.E. Practices and ensure sustainability. In January 2004, the company opened a farmer support center called the Starbucks Coffee Agronomy Company in Costa Rica that contained a team of experts in soil management and field-crop production (agronomists), and in coffee quality and sustainable practices. These experts collaborated directly with farmers and suppliers in Central America and provided services to farmers and suppliers in Mexico and South America. This helped build long-term and strategic relationships with members in the supply chain who were committed to the sustainable production of high-quality coffee. They also administered C.A.F.E. Practices, oversaw regional social programs, and engaged with local government on sustainability issues.

Starbucks also bought certified or eco-labeled coffees that had been grown and sold in ways that helped preserve the natural environment and/or promote economic sustainability. There were three such types of environmentally sustainable coffee purchased by Starbucks:

***Conservation Coffee*** (shade-grown): Starbucks, through its partnership with CI (a nonprofit organization dedicated to protecting global biodiversity), encouraged coffee farmers to use traditional and sustainable cultivation methods. The basic aim was to protect shade trees, which were often stripped away and replaced with tight rows of coffee trees on large coffee plantations. This not only destroyed the habitats of numerous species but also resulted in lower coffee production.

***Certified Organic Coffee***: This coffee was grown without the use of synthetic pesticides, herbicides, or chemical fertilizers to help maintain healthy soil and groundwater.

***Fair Trade Certified Coffee***: Through a licensing agreement with TransFair USA, Starbucks tried to ensure that coffee farmers were fairly compensated for their crops. The Fair Trade Certified Coffee label certified that the coffee met Fair Trade criteria. These criteria focused primarily on price and other sustainable needs. Fair Trade Certified coffees only came from democratically owned cooperatives, not large farms or coffee pulled across supply channels.

In order to improve farmers' access to financing, Starbucks provided loan funds to several organizations to ensure that farmers could obtain affordable loans and to help them gain some financial ability to improve their agriculture techniques. In 2004, Starbucks committed $6 million to several loan programs. The importance and alignment of this upstream support component was highlighted in a quote from Shari Berenbach of Calvert Foundation: "Starbucks has taken a leadership position by aligning its investment capital with the company's mission and products to create more sustainable coffee growing communities."

Finally, Starbucks worked with local farmers to understand the greatest needs of their rural communities, which often lacked basic necessities such as adequate housing, health clinics, schools, good roads, and fresh drinking water. Starbucks collaborated with these farmers to develop projects that helped meet their needs, especially in areas where the company bought large volumes of coffee. In fiscal 2004, the company contributed nearly $1.8 million for 35 social programs.

## C.A.F.E. PRACTICES IMPLEMENTATION

There were two main challenges facing C.A.F.E. Practices implementation that could potentially be addressed with better integrated information technologies. First, since some members of the supply chain had very poor information systems, it could be very difficult to gain economic transparency—a key goal of C.A.F.E. Practices—from these members. Second, as C.A.F.E. Practices were updated and refined, it became a daunting job to effectively communicate the revised requirements and practices to farmers, suppliers, and other members of the industry.

In addition, it had been a very labor-intensive and slow process to evaluate farmers for scores in the C.A.F.E. program. Auditors had not choice but to travel to the farms, which were often located in barely accessible areas.

The company was in the process of developing an internal system to track compliance with C.A.F.E. Practices, and link such data to support procurement. The plan was to integrate the C.A.F.E. Practices data, at the time stored in spreadsheets, with the more versatile database, and to then link the data with its procurement system, together with other information systems on quality data.

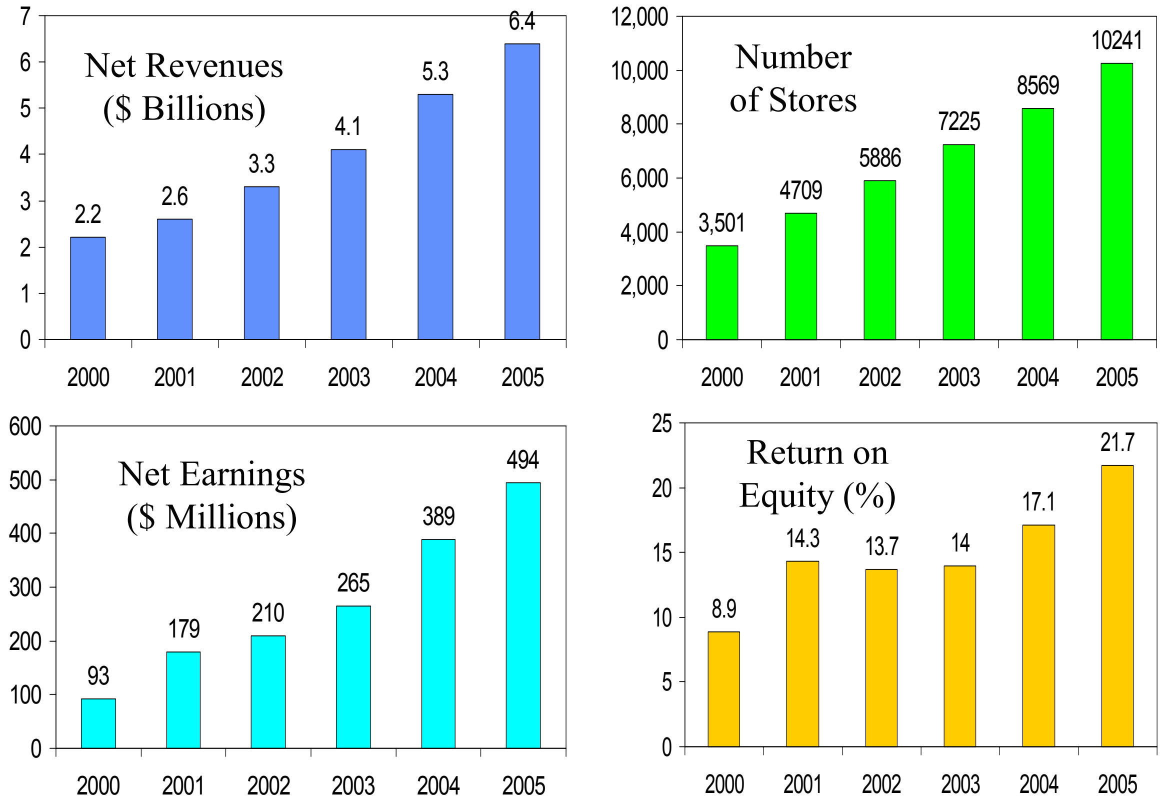
To Starbucks, it seemed that a more comprehensive information system was needed to support a large-scale implementation of C.A.F.E. Practices.

## FUTURE OF C.A.F.E. PRACTICES

As Starbucks embarked on the aggressive expansion of C.A.F.E. Practices towards meeting its goal of supplying the majority of its coffee through the program by 2007, there were a number of internal and external challenges. Internally, Starbucks would have to address its information system issues. Externally, Starbucks had to find an effective way to communicate and interface with its low-tech suppliers.

The opportunity, however, was tremendous. If Starbucks was able to overcome the implementation issues that it faced, C.A.F.E. Practices could go a long way towards improving the sustainability of its coffee supply chain while at the same time improving Starbucks' image as a socially responsible corporation.

**Exhibit 1**
**Starbucks Corporate Performance**



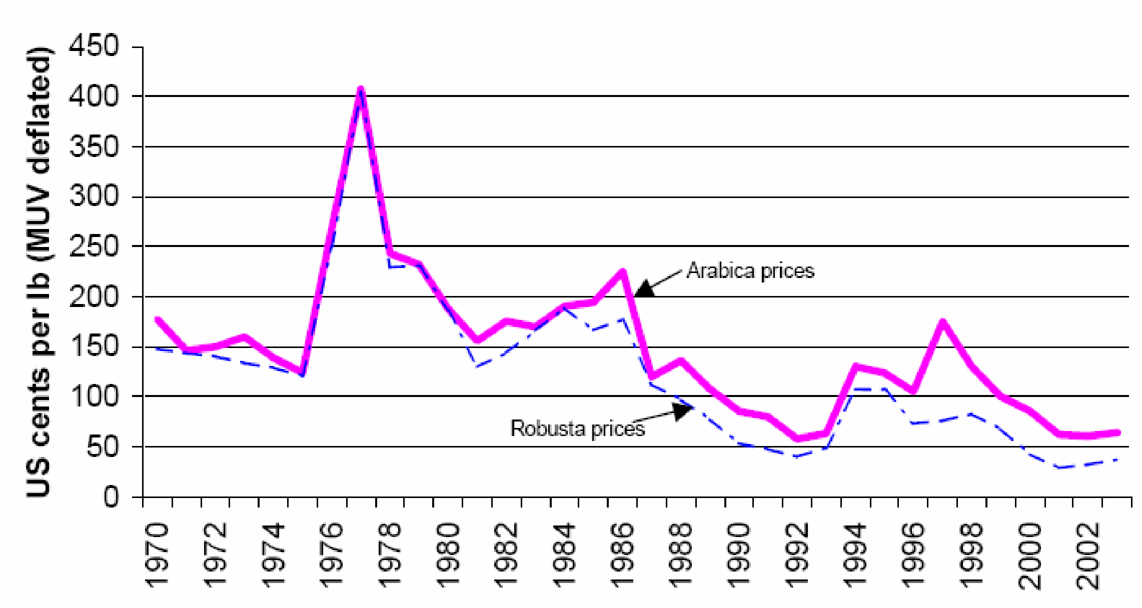

Source: Starbucks Annual Reports.

## Exhibit 2
## Starbucks' Statement of Earnings

| *Fiscal Year Ended* | **Oct 2, 2005 (52 Wks)** | **Oct 3, 2004 (53 Wks)** | **Sept 28, 2003 (52 Wks)** |
|---|---|---|---|
| STATEMENTS OF EARNINGS DATA | | | |
| Net revenues: | | | |
| Company-operated retail | $5,391,927 | $4,457,378 | $3,449,624 |
| Specialty: | | | |
| Licensing | 673,015 | 565,798 | 409,551 |
| Foodservice & other | 304,358 | 271,071 | 216,347 |
| Total specialty | 977,373 | 836,869 | 625,898 |
| **Total net revenues** | **6,369,300** | **5,294,247** | **4,075,522** |
| Cost of sales including occupancy costs | 2,605,212 | 2,191,440 | 1,681,434 |
| Store operating expenses | 2,165,911 | 1,790,168 | 1,379,574 |
| Other operating expenses | 197,024 | 171,648 | 141,346 |
| Depreciation & amortization expenses | 340,169 | 289,182 | 244,671 |
| General and administrative expenses | 357,114 | 304,293 | 244,550 |
| Subtotal operating expenses | 5,665,430 | 4,746,731 | 3,691,575 |
| Income from equity investees | 76,745 | 59,071 | 36,903 |
| **Operating income** | **780,615** | **606,587** | **420,850** |
| Interest and other income, net | 15,829 | 14,140 | 11,622 |
| Earnings before income taxes | 796,444 | 620,727 | 432,472 |
| Income taxes | 301,977 | 231,754 | 167,117 |
| **Net earnings** | **$494,467** | **$388,973** | **$265,355** |

Source: Starbucks Form 10K, p. 23, (filed 12/16/2005).

**Exhibit 3**
**Arabica and Robusta prices, 1970-2002**




Source: Data retrieved February 12, 2007, from Global Financial Data.

## Exhibit 4
## Specialty Coffee Factoids

• Specialty coffee is defined as a coffee that has no defects and has a distinctive flavor in the cup.

• Specialty coffee, a term that refers to the highest-quality green beans roasted by true craftspeople, is surprisingly affordable. One cup costs about 24 cents (based on 50 cups/lb @ $12/lb)—making it cheaper than bottled water.

• Every day, Americans drink more than 300 million cups of coffee; 75% of those cups are home-brewed.

• In 2005, 15 percent of the adult American population enjoyed a daily cup of specialty coffee.

• Like wine and honey, specialty coffee has a unique flavor thanks to the micro-climates that produce it.

• In 1683, one pound of coffee in New York was worth as much as four acres of land.

• To be considered truly fresh, coffee should be ground right before brewing and brewed within three to seven days of roasting.

• Surprisingly, a 1 oz. espresso contains less caffeine (approx. 40 mg) than a regular 8 oz. serving of drip coffee (approx. 85 mg). In fact, in the espresso brewing method, water is in contact with the grounds for only 20 to 25 seconds and extracts less caffeine than methods that put water in contact with the grounds for several minutes.

• Strong-tasting coffee has no more caffeine than its weak-tasting counterpart. Caffeine contributes no taste; it's a product of the type of bean, water-to-coffee ratio, and brewing method.

• Seventy percent of the world's coffee production is the Arabica species.

• Thanks to some popular commercials, most of us believe that coffee originated in Colombia or Brazil. Not so; it originated in Ethiopia.

• The global coffee industry employs more than 20 million people.

• It takes approximately 42 coffee beans to make an average serving of espresso.

Source: "Specialty Coffee Factoids," Specialty Coffee Association of America, http://www.scaa.org/pdfs/specialtycoffeefacts.pdf (February 6, 2007).

## Exhibit 5
## Starbucks' Main Competitors

***Caribou Coffee*** (http://www.cariboucoffee.com)

The company owned and operated the second largest non-franchised coffee chain in the U.S. (behind Starbucks), with about 300 stores in 12 states and the District of Columbia. The outlets, designed to resemble ski lodges and Alaskan cabins, offered a wide variety of coffee blends as well as specialty coffee drinks. The company also sold whole bean coffee and related brewing supplies. Caribou Coffee was founded in 1992 by John and Kim Puckett. Crescent Capital, the private equity arm of First Islamic Investment Bank, bought a 70 percent stake in Caribou Coffee in 2000—the ownership was later increased to almost 90 percent.

***Diedrich Coffee*** (http://www.diedrich.com)

Diedrich Coffee had more than 515 coffeehouses in the U.S. and 13 other countries. The nation's #2 coffeehouse company (behind Starbucks), Diedrich's outlets operated under the brands Diedrich Coffee, Gloria Jean's, and Coffee People. The company also supplied wholesale coffee to restaurants (such as Ruby Tuesday and Ruth's Chris Steak House), office coffee suppliers, and other hospitality and specialty retail customers. Chairman Paul Heeschen controlled 32 percent of Diedrich Coffee.

***Dunkin Brands*** (http://www.dunkinbrands.com)

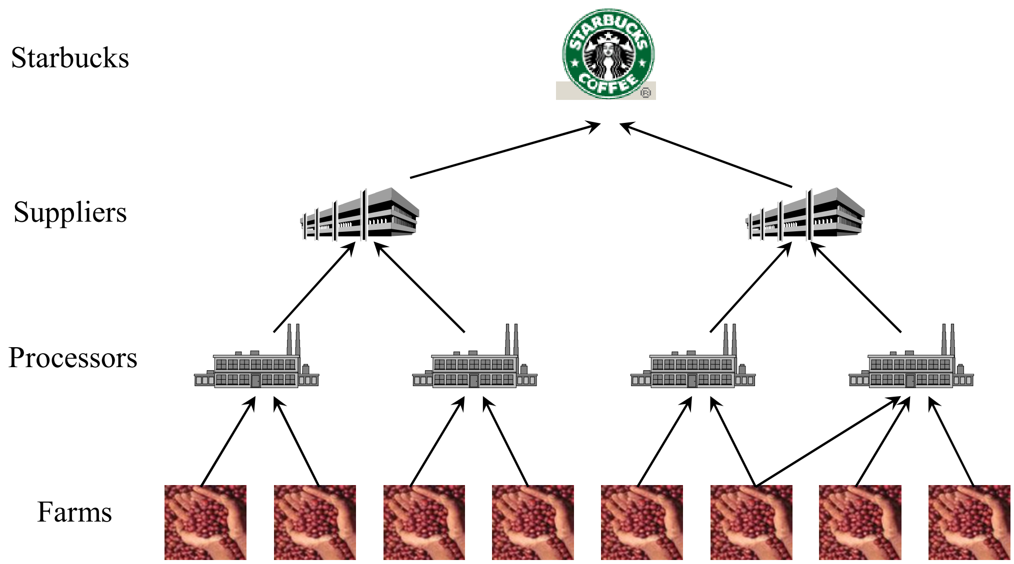
A division of wine and spirits maker Allied Domecq, it franchised more than 12,000 quick-service eateries, including Dunkin's Donuts, Baskin-Robbins, and Togo's. With about 6,000 locations (more than 4,400 in the US), Dunkin was the world's leading chain of doughnut shops and Baskin-Robbins was a leading seller of ice cream and frozen snacks with its more than 5,400 outlets (about half are located in the US). Dunkin's Togo's shops (more than 400 West Coast units) served a variety of made-to-order sandwiches. About 1,100 locations offer a combination of the company's brands. In 2005 Dunkin's parent company was taken over by Pernod Ricard.

***Others***

In addition, numerous restaurants were picking up on the growing popularity of specialty coffees and had installed machines to serve espresso, cappuccino, café latte, and other coffee drinks to their customers. Starbucks also faced competition from nationwide coffee manufacturers such as Kraft General Foods (the parent of Maxwell House), Procter & Gamble (the owner of the Folger's brand), Sara Lee, and Nestlé, the latter two also distributed their coffees through supermarkets. There were also a number of specialty coffee companies that sell whole-bean coffees in supermarkets.

Source: "Coffeehouses and Donut Shops – US – February 2005," Mintel Reports, Mintel International Group Limited.

**Exhibit 6**
**The Starbucks Coffee Supply Chain**




Source: Starbucks. Reprinted by permission.

## Exhibit 7
## C.A.F.E. Practices Self-Evaluation Checklist

**Product Quality – Required**
- Green Preparation – Prerequisite
- Cup Quality – Prerequisite

**Economic Accountability – Required**
- Demonstration of Economic Transparency
- Equity of Financial Reward
- Financial Viability

**Social Responsibility**
*Hiring Practices and Employment Policies:*
- Minimum/Living Wage/Overtime Regulation*
- Freedom of Association/Collective Bargaining
- Vacation/Sick Leave Regulation
- Child Labor/Discrimination/Forced Labor*

*Worker Conditions:*
- Access to Housing, Water and Sanitary Facilities
- Access to Education
- Access to Medical Care
- Access to Training, Health & Safety

**Coffee Growing – Environmental Leadership**
*Protecting Water Resources:*
- Watercourse Protection
- Water Quality Protection

*Protecting Soil Resources:*
- Controlling Surface Erosion
- Improving Soil Quality

*Conserving Biodiversity:*
- Maintaining Coffee Shade Canopy and Natural Vegetation
- Protecting Wildlife
- Conservation Areas and Ecological Reserves

*Environmental Management and Monitoring:*
- Ecological Pests and Disease Management and Reducing Agrochemical Use
- Farm Management and Monitoring Practices

**Coffee Processing – Environmental Leadership**
***Wet Milling***
*Water Conservation:*
- Minimizing Water Consumption
- Reducing Wastewater Impacts

*Water Management:*
- Waste Management Operations/Beneficial Reuse

*Energy Use:*
- Energy Conservation/Impacts

***Dry Milling***
*Waste Management:*
- Waste Management Operations/Beneficial Reuse

*Energy Use:*
- Energy Conservation/Impacts

Source: Starbucks. For more information, see "C.A.F.E. Practices: Generic Evaluation Guidelines," Starbucks Coffee Company, November 9, 2004, http://www.scscertified.com/csrpurchasing/docs/CAFEPracticesEvaluationGuidelines110904English.pdf.

## Exhibit 8
## Success Story of a Coffee Farmer – Investment Payoff for C.A.F.É. Standards

For years, the Santa Teresa farm did well enough by producing regular extra-prime coffee rather than higher quality specialty grade. But that changed when world coffee prices hit rock bottom several years ago. Ervin Pohlenz Cordova, the son of the farm's owner, wasn't earning enough for his crops to cover the farm's expenses. The farm nearly went bankrupt.

Cordova was introduced to Starbucks through his exporter and discovered he could earn more by producing higher-quality coffee. Santa Teresa is located in Chiapas, Mexico, an area known for its optimal altitude, fertile soil and shade trees—perfect coffee-growing conditions. Some investments were needed to improve quality and implement sustainable farming practices, a commitment Cordova was willing to make, despite initial resistance from his elderly father.

It took three years before the coffee grown on Santa Teresa farm reached Starbucks quality standards. Along the way, the exporter worked with Cordova on implementing quality improvements. In 2003, Starbucks signed a three-year contract to buy all of Santa Teresa's high-quality coffee at premium prices and added a provision that earmarked funds for social improvement and environmental protection projects to benefit the farm. Cordova's accomplishment is now the pride of his father.

The Starbucks contract gives Pohlenz security in knowing he has a buyer for his future crops and one that contributes to the quality of life on Santa Teresa farm. "Now I feel that I will work my entire life as a coffee producer because my farm is sustainable," he said. Clearly, Cordova's investment is paying off. And for Starbucks, we gain a wonderful source of high quality coffee grown under sustainable conditions. Cordova is a firm believer in C.A.F.E. Practices, and his goal is to become a Starbucks preferred supplier in 2005.

Source: "Starbucks—Corporate Social Responsibility Report, FY04," Starbucks Corporation.