Starbucks: Shareholder Value Maximisation Versus Social Responsibility

In the 2019 fiscal year annual letter to shareholders, Kevin Johnson, CEO of Starbucks, stated that the company was 'focused on strengthening communities and leading in sustainability, we believe the pursuit of profit is not in conflict with the pursuit of doing good' (Johnson, 2020). Known as a company with a leading global social impact and a great reputation for their contributions to environmental, social and governance issues, Starbucks includes social responsibility in their business strategy and balances their priorities among all of their stakeholders: employees, customers, suppliers, the natural environment, communities and shareholders. Their leadership aims to do more than create stakeholder value – their overall purpose is to create ethical and sustainable business by embracing the company's mission to 'inspire and nurture the human spirit' (Dahlstrom & Duong, 2020). However, taking a more careful look at Starbucks' recent activity of repurchasing up to 40 million shares of the company's stock (Starbucks, 2020a: p.18) and incurring such a huge amount of debt that the date/equity ratio exceeded 800% (Cannivet, 2019), one may begin to question whether contribution to shareholder value became the criteria of their business strategy and influenced their ESG outputs (Hiss, 2013). Although management aims to pursue sustainable long-term growth, higher growth is sacrificed for higher value.

In this paper, I look firstly at Starbucks' financial and ESG performance from their past three-year annual reports and analyse that Starbucks' general reputation and positive impacts are based on facts rather than simply effective propaganda. All data relevant to Starbucks has been taken from the same annual report (Starbucks, 2020a). Secondly, I investigate how Starbucks maximises their shareholders' value by repurchasing shares, and look at their top management remuneration to analyse whether they are moving away from financialised management and whether the components of the annual incentive bonuses are linked to the achievement of their announced sustainability goals. I then explore the real world environmental, social and sustainability issues that Starbucks is embracing from various stakeholders and governmental regulations. This paper closes with suggestions for what steps should be taken to maintain the company's positive brand reputation, position them as leaders on environmental sustainability and create great value for all stakeholders.

Profit and Sustainability: Co-Existing Goals

Founded in 1985, Starbucks now operates in 81 markets with a total of 15,834 stores. They have 400,000 partners in over 31,000 companies around the world (Starbucks, 2020a: p.17). As CEO Keven Johnson pronounced, 'by embracing a longer-term economic, equitable and planetary value, we will create greater value for all stakeholders' (Starbucks, 2020b). Starbucks has high corporate social responsibility performance in balancing the interests of most of its stakeholders, including shareholders. To pursue their long-term strategy, include a 'Growth at Scale' agenda which aims to 'accelerate U.S. and China, expand global reach, and increase returns', Starbucks focuses on shareholder value creation and also invests in their commitment to meaningful social impact (Starbucks, 2020c: p.4). The number of stores opened in the U.S. increased from 8,575 in fiscal 2018 to 8,791 in fiscal 2019, and stores in China also increased from 3,521 to 4,123 in the same period. Total revenue increased by 7% to $26.5 billion in fiscal 2019 (Starbucks, 2020c: p.3). These investments have boosted their non-GAAP EPS by 17% to $2.83 and returned $12 billion to shareholders (Starbucks, 2020a: p.23). Starbucks has proven itself to be committed to fulfilling its 'growth at scale' agenda.

One critical signal that Starbucks management is taking sustainability seriously and making significant investments in such practices is the issuance of the new $1 billion bond in fiscal year 2019, the largest sustainability bond following two previously-issued bonds in fiscal years 2016 and 2017 (Morgan Stanley Institute for Sustainable Investing, 2018). The bond issuance offers them the ability to raise capital for social and environmental efforts, and also signals to their shareholders that they are making meaningful investments in their strategic sustainability commitments with measurable results (Morgan Stanley Institute for Sustainable Investing, 2018). In order to build the sustainable coffee value chain and reach their goal of a 100% C.A.F.E. certified supply chain, Starbucks has invested $150 million in providing debt financing and $12 million in the Starbucks foundation (Starbucks, 2020c: p.4). Additionally, Starbucks' 2020 preliminary targets include 50% reduction in carbon emissions in Starbucks' direct supply chain, conserving or replenishing 50% of all the water it draws for its operations, and 50% reduction in waste sent to landfills from stores and manufacturing (Starbucks, 2020d).

As can be seen from highlights of their environmental, social and governance policies, it can be proved that Starbucks aims genuinely toward their stated goals by making commitments to sustainability and investing in farmer loans, greener power, greener stores, straw-less lids, training new technologies, and positive economic impacts on communities (Starbucks, 2019a). Moreover, after decades of progress, Starbucks reached gender and race pay equity among all employees with the same roles in the U.S. (Wiener-Bronner, 2018), which proves their commitment to taking care of their employees. As affirmed by Patrick Grismer, CFO of Starbucks, 'the bond demonstrates Starbucks commitment to meaningful, continual progress toward our aspiration of sustainable coffee, served sustainably. It also illustrates a trend toward heavier interest from investors in our socially and environmentally focused projects' (Starbucks, 2019b).

Big Share Buybacks Limit Long-Term Growth Potential

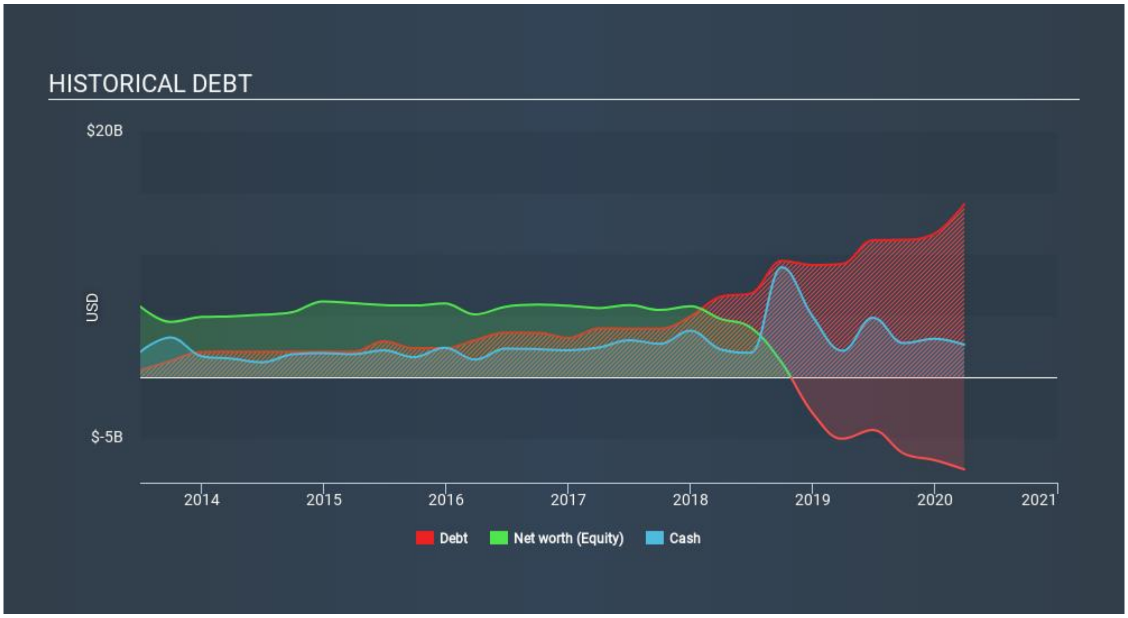
However, when noticing that one of Starbuck' biggest successes in previous years has been the result not only of the Trump administration's tax cuts but also Starbucks' aggressive share buybacks (Foroohar, 2019), one may begin to doubt Starbucks' professed 'long-term' growth and their future maintenance on a 10% profit expansion rate (Forhhoar, 2019). Of course, the coffee giant's confidence in their own financial power is far from unfounded. From September 2019, Starbucks repurchased 23,532,147 shares and returned to shareholders a total of $12.0 billion in fiscal year 2019, compared to $8.9 billion in fiscal year 2018. Resources used by financing activities totalled $10.1 billion in 2019, compared to $3.2 billion for fiscal year 2018 (Starbucks, 2020a: p.38). Suffering from disruptions due to COVID-19, Starbucks still repurchased their equity to bolster share prices and pay back their shareholders, demonstrating how strong their financial resources are. As CEO Johnson said in a 2020 press release, 'the increase in our share repurchase program reflects our confidence and optimism about the long-term growth opportunity for our business' (Starbucks, 2020e).

However, questions remain. Is Starbucks trading off short-term profit against long-term growth? Do they still have enough growth potential during this global economic crisis to maintain commitments to all the stakeholders? The reality shows that their share buybacks incurred a huge debt load, which has tripled over the past few years (Foroohar, 2019). In 2017, Starbucks had a debt/equity ratio of 72% and about $3 billion in debt; now the company carries $11.170 billion in debt and negative $7.533b in equity, resulting in a negative 186.9%

debt/equity ratio (Figure 1). This means that they are carrying a huge amount of liability and cannot be covered by operating cash flow.

Figure 1

Starbucks' Debt to Equity History

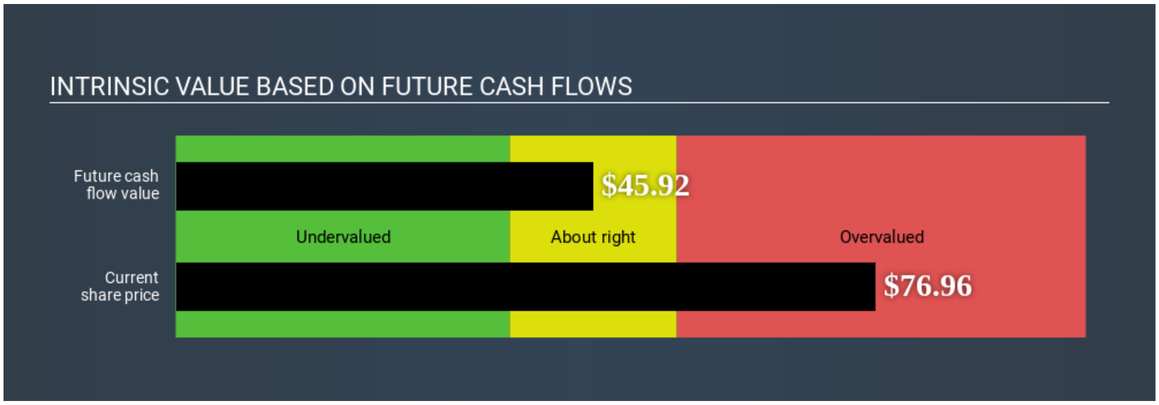


Source: Simply Wall Street

In addition, although their EPS (earnings per share) rose 30**%** from previous years, their total operating income is decreasing, a poor long-term approach to driving sales. Currently, their stock SBUX ($76.96) is trading above the estimated fair value ($45.92) (Figure 2), indicating that their stock price is overvalued and that there is a potential risk of a stock price bubble.

Figure 2

Starbucks Share Price vs. Fair Price



Source: Simply Wall Street

When looking at the remuneration of their top management, their incentive bonus plan components included base salary, net revenue (weight 40%), and operating income (weight 60%) in fiscal year 2018. In fiscal year 2019, a new indicator, 'a three-year relative total shareholder return (TSR)' modifier (weight 30%) is newly implemented to the top management incentive plan (Starbucks, 2020c: p.39), which shows that shareholder return holds an increasingly dominant position in their strategy. However, in their fiscal year 2019 executive compensation overview, no objectives related directly to the achievement of their sustainability goals (Starbucks, 2020c: p.39). If their sustainability goals genuinely align with shareholders' interests, Starbucks should include non-financial factors such as societal and environmental metrics in their evaluation.

Business Ethics and Financialised Sustainability

In 2018, Starbucks announced a strategy to 'accelerate growth and create long-term shareholder value' (Bloomberg, 2018). However, when the tax boondoggle was over, they pulled forward $2 billion of share buybacks, which is approximately 67% of their cash on the balance sheet (Lucas, 2020). In order to compete in a tough global economy, businesses can find it easier to make profits when following a financial business model rather than investing in innovation (Batt & Appelbaum, 2013). Starbucks is struggling on the principal-agent problem by aligning the interests of top management and shareholders. When Starbucks missed sustainability targets one cannot help but wonder, is their sustainability financialised? Starbucks revised the goal to serve 5% of its drinks in tumblers by 2015 after they failed to meet the goal to serve 25% of the drinks in reusable cups by that year. However, they failed again and set a new goal in their fiscal year 2019 social impact report to have 2.8% of drinks served in reusable cups by 2022 (Li, 2019). Clearly, there has been little effort made toward any such sustainability goal. Although there is no evidence for how difficult this policy would be to achieve, objectively Starbucks falls short on numerous sustainability targets. One reason for this may be that reusable cups or packaging is not one of the metrics that highly interest shareholders; as stated by Hiss, 'when financialization biases strategy towards "focused" brands and operations, contribution to shareholder value becomes the criterion for all aspects of a firm's strategies' (Hiss, 2013).

If Starbucks' corporate social responsibility (CSR) aligns with shareholder value, how free are they to develop this (Jones & Nesbet, 2011)? They have achieved high CSR performance in addressing the interests of most of their stakeholders. However, recent labour, coffee farmer, ethical trade and environmental cases that recently occurred around the world call into question Starbucks' commitment to ethical goals. In 2019, forced labour and modern slavery were reported from Starbucks' C.A.F.E. Practices-certified plantations in Brazil (Canning, 2019). Starbucks' C.A.F.E. Practices program failed to address these issues or to meet any progress requirements toward paying living wages and minimum price guarantees (Canning, 2019). When looking at the price of 'green' coffee, it has dropped from \$0.90 to \$1.0 per pound and is trading well below the cost of production (Figure 3). Farmers are earning the same amount or less than they did 20 years ago. Meanwhile, Starbucks' share price is growing steadily (Figure 4). Starbucks talks a big game regarding eco-friendly and sustainable coffee, but, if they cannot accomplish even break-even commitments to their coffee farmers, they will never achieve true sustainability (Canning, 2019).

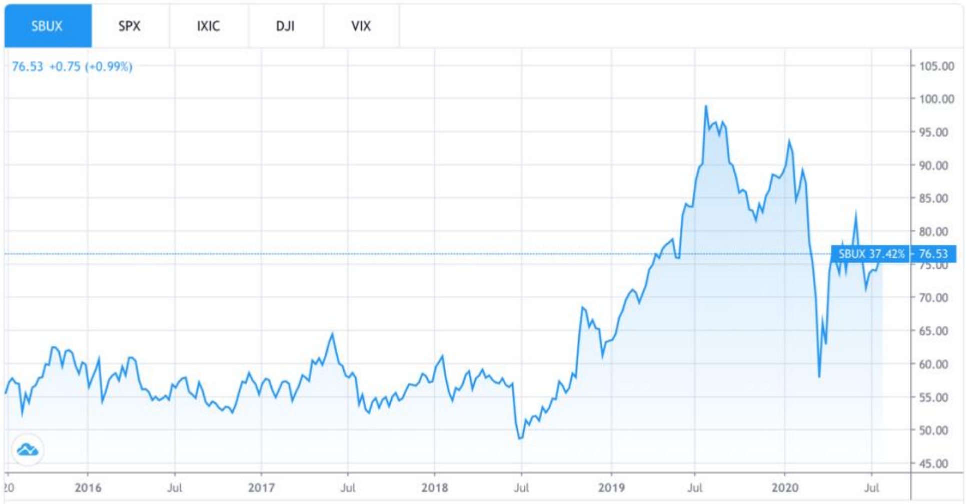
Figure 3

Coffee Price Historical Chart Data, 2016-2020

Source: Macrotrends

Figure 4

Starbucks Corp SBUX Stock Chart, 2016-2020



Source: TradingView

Conclusion

A common term when assessing a firm's performance is 'triple bottom line' (TBL), also known as 'people, planet and profit'. (Slack & Brandon-Jones, 2019). In Starbucks' case, they measure themselves not only on the economic profit that they generate for their shareholders, but also on the impact of their operations on society and the environment (Slack & Brandon-Jones, 2019). As proven above by information in their annual reports, it is known that Starbucks managers are dedicating themselves to achieve profit as well as long-term sustainability by maximising the value of all their stakeholders, including shareholders. Starbucks' sustainability bond framework is impactful, outlining socioeconomic empowerment, essential services and green building (Sustainalytics, 2019). However, as is evident from their share buybacks and debt issues, Starbucks is also unlikely to move away from financialised management to solve agent problems. Their primary commitment is moving toward profit that limits their growth.

What actions should Starbucks take moving forward? Firstly, as stated by Hiss, 'one approach that aims to standardize sustainability accounting indicators is the development of sustainability key performance indicators, to be integrated into corporate annual financial reports' (Hiss, 2013). Starbucks must clean their supply chain and improve their CSR performance in order reach a 100% C.A.F.E certified sourcing chain and include this factor in their evaluation. Secondly, their sustainability goals, such as eco-friendly menus, reusable packages and greener building require significant consumer buy in (Sagan, 2020). Starbucks must approach their own communities, where their main consumers live, and change cultural aspects such as drive-throughs and disposable coffee purchasing in order to achieve their environmental goals. Thirdly, Starbucks needs become 'buy in' for their shareholders to support the company sustainability goals rather than short-term returns, and build a trust mechanism between shareholders and management. As CEO Jonson states in a letter to shareholders, 'we declare our concern for our planet's future and commit to do more. I invite you to join us' (Johnson, 2020). The hope is that Starbucks can maintain their leading position to create global social impact, improve their CSR performance by aligning all stakeholder needs, adhere to the 'pursuit of doing good' to maximise environmental benefits (Johnson, 2020), and overcome the downturn of COVID-19 and keep delivering ethical coffee to consumers and communities worldwide.

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