

Different Brew

Eyeing a Billion Tea Drinkers, Starbucks Pours It On in China

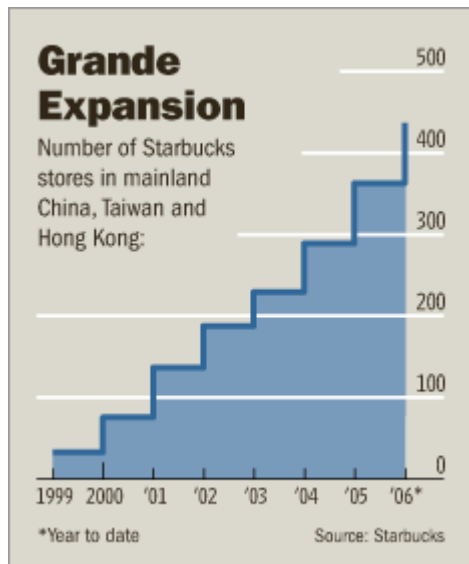
Its Big Challenge: Creating
A New Taste for Coffee,
And Charging Top Prices
Wooing the 'Little Emperors'
By JANET ADAMY

SHANGHAI -- To familiarize Chinese people with Starbucks coffee, barista Stephanie Chen pours customers a one-ounce sample and invites them to join her for a tasting. Then she blurts out the first thing that comes to mind when the brew hits her palate.

"Dry land," Ms. Chen declared recently after slurping a robust blend from a tiny white cup. "In the west in China, it is always hot and dry and it reminds me of those places."

Ms. Chen's tastings are an important part of Starbucks Corp.'s plans for global growth. The Seattle company aims to one day have thousands of stores here, eventually making China its largest market outside the U.S.

But Starbucks faces a big obstacle: Most of China's 1.3 billion people don't care for the chain's signature product. Coffee is so unpopular in China's tea-drinking culture that until recently many Starbucks didn't brew regular drip coffee unless a customer ordered it.



Now Starbucks is betting a new generation of Chinese with growing spending power and an appetite for high-status brands will flock to its stores. "Coffee represents the change," Wang Jinlong, president of Starbucks Greater China, said while sitting at a riverside Starbucks here on a hot afternoon. The patio was packed with young adults fidgeting with cellphones as they sipped lattes and Frappuccinos topped with whipped cream. "The disposable income is concentrated on the young people and this is the place they want to come."

Starbucks's aspirations here underscore a dilemma facing many Western companies chasing the nation's huge market: **Should they change their offerings to have more local appeal, or attempt to change Chinese tastes?**

The coffee giant is pursuing the second approach. It's trying to draw in Chinese customers with a new type of informal gathering place. Once captive, that's when consumers' coffee education begins. The chain stacks cream and sugar counters with brochures titled "Coffee Brewing Wisdom" and others that answer questions like "What is espresso?" Workers float through stores passing out small cups of pumpkin-spice latte and other drinks. Good-for-you messages about coffee are sometimes part of the pitch.

A 16-ounce latte -- what Starbucks calls a "grande" -- costs about \$3.50 in Shanghai. That's a luxury in a city where the average annual wage is about \$3,800.

By contrast, some of the most successful Western companies pushing into China have tweaked their products to better suit locals. Yum Brands Inc., whose KFC is the largest restaurant operation in China, has a new Chinese fast-food chain that serves noodles and rice. General Motors Corp. has restyled a Cadillac for China -- one with a more luxurious back seat for affluent Chinese who have their own drivers.

Starbucks has competition from a new generation of Chinese teahouses -- some of which offer both traditional beverages and a social, laid-back coffeehouse culture. China's tightly regulated business environment also throws up hurdles. Financial rules prevent the chain from offering a Starbucks payment card. The country's fragmented government and currency-conversion limits make banking generally difficult.

"If I want to move money out of China, it's a hellish process," says Charles Jemley, Starbucks vice president of finance in China. Book bags and coffee mugs barely made it out of customs in time for Starbucks to pass them out at a rural charity effort. Poor water quality in some cities means Starbucks has to install elaborate filtering systems.

Starbucks is relying on Mr. Wang to navigate through the rough patches. He calls the target market China's "little emperors." China's one-child rule created a generation who have been pampered by parents and grandparents and have the means to make indulgent purchases. Instead of believing in collective goals, these young people embrace individuality. Starbucks is in sync with that, says Mr. Wang, given its customized drinks, personalized service and original music compilations.

"Their view of this world is very different," Mr. Wang, 49, says. "They have never gone through the hardships of our generation."

Most of Starbucks's 436 locations in mainland China, Taiwan and Hong Kong offer more food and seating than its American stores. About 90% of orders are consumed on the premises. The U.S. average is about 20%, Starbucks says. Crowds peak in Chinese Starbucks during the afternoon. Mornings are so slow that employees spend the early hours restacking displays of coffee mugs.

The drinks menu focuses on the same coffee-based beverages as in the U.S., with tea playing only a minor role. But stores also sell green-tea cheesecake and Chinese moon cakes. The latter is a special pastry served during the Mid-Autumn Festival.

Competitors consider the coffee focus a weakness given traditional Chinese tastes. "They will enjoy tea more than coffee," says Garvin Lau, a general manager for Real Brewed Tea. Launched in Hong Kong, the chain of teahouses aims to be "the Starbucks of tea," Mr. Lau says. It has carefully studied the Seattle chain. Real Brewed Tea's 100 or so stylish locations have high ceilings, bright green chairs and menus that tell customers the chain is "determined to become a lifestyle." The stores sell basic tea drinks for about \$1.75, slightly less than what Starbucks charges.

Mr. Wang has seen Starbucks's global coffee culture percolate for more than a decade. The son of textile factory workers, Mr. Wang grew up in Beijing during the Cultural Revolution, when millions were sent to villages to perform manual labor. He was assigned to teach English, and then to work for the Chinese government after he finished college. The government sent him to law school in the U.S. to help China better understand American law.

After he graduated from Columbia University's law school in 1988, Mr. Wang planned to work in the U.S. for a year and return to China. But in the wake of the Tiananmen Square protest crackdown, he moved to Seattle and took a job at the law firm Preston Gates & Ellis.

He arrived at Starbucks to start its legal department in 1992, when it had 120 U.S. stores. Four years later, he helped open its first overseas outlets in Japan. Then Starbucks started looking at China.

The company surveyed Chinese consumers and came up with a list of the top 20 reasons they visit cafes. Coffee-drinking ranked sixth. Consumers said the No. 1 reason they go to cafes is to have a place to gather.

Executives didn't think the coffee part stood in their way. They hoped the appeal of the brand and experience of sitting inside Starbucks would be enough to draw Chinese fans. Many of Starbucks's espresso drinks are so heavily sweetened they don't taste like coffee, and some Frappuccinos don't contain any coffee. In 1999, Starbucks opened its first China store in Beijing's China World Trade Center.

Expansion was slow. Government regulations forced Starbucks and other international retailers to open stores through partnerships with local firms. Starbucks left many of the operating details to the partners and told them to call if they needed anything, executives say. The result: inconsistencies that wouldn't be tolerated in the U.S., such as a big disparity in food offerings from store to store.

Hsu Ta-lin, chairman of H&Q Asia Pacific, a private-equity firm, was an investor in Starbucks's first Beijing stores. At the time, there were "a lot of people laughing at me," he recalls. Even a year into the business, Mr. Hsu says he "certainly did not have the feeling this was going to be a resounding success." He was also concerned that drink prices, at about \$3 per cup, were too high.

By 2000, Mr. Wang was restless to return to China. He had promised his wife he would take her back home. He left Starbucks and moved to Hong Kong, then Shanghai. He was so bored without a job, he says, he felt physically sick. So he volunteered his expertise to a chain of convenience stores -- his way, he figured, of helping to create something new for China.

Meanwhile, he kept his eye on Starbucks. He saw Chinese businesses, including a dairy company, growing faster than the coffee chain. The government had installed new regulations that promised to make it easier for multinationals like Starbucks to expand without local partners. On visits back to Seattle, Mr. Wang met with Starbucks Chairman Howard Schultz and urged him to move more quickly. "In China there's only one speed: faster," Mr. Wang told Mr. Schultz.

"I knew he was right but we didn't have the right people," Mr. Schultz says. Late last year Mr. Wang came back to Starbucks to lead the expansion.

Mr. Wang overhauled the company's growth strategy to focus more on adding stores in China's metropolises instead of entering lots of new cities. Executives also looked at adding lower-priced food items, like small pastries, to attract customers unwilling to pay for its drinks.

To raise coffee's Chinese profile, Starbucks has begun with its employees. Many of them had tasted only instant coffee, the most common variety in China, before joining the company.

On a recent morning at Starbucks's Shanghai headquarters, workers gathered in the lobby and divided into teams for a coffee-tasting competition. They sipped two samples of coffee and guessed which country it came from and its level of acidity. Some workers wrinkled their noses at the taste.

The chain also holds more formal tastings for customers, like the ones Ms. Chen performs at her Shanghai store. After she pours samples, she tells patrons to smell, then sip the coffee and describe how it makes them feel. Ms. Chen tells customers that coffee

provides a good start to their day, and that it may change their mood. If patrons don't like the java samples, workers encourage them to come back for another tasting, or offer them a different drink to get them on the "coffee journey," says store manager Bruce Yin.

Starbucks will not disclose sales or profit details for its China stores. The company cites its expansion in Japan as proof it can carve out a market in a tea-drinking country -- even though the chain has struggled to raise sales there. Starbucks says China stores have lower sales than U.S. stores. That's offset by cheaper labor and other lower operating costs. Though it declines to provide China-specific details, Starbucks says it plans to eventually have 20,000 locations overseas -- with a substantial portion of those in China, says Martin Coles, president of Starbucks Coffee International.

Mr. Wang concedes that Chinese enjoy the coffee ritual -- being seen at a cafe, toting the signature cups -- more than the brew itself. But there may be signs of change. For example, Sara Lee Corp. recently began selling its Senseo coffee machine, a high-end home brewer, for about \$100 in Chinese retail outlets.

And Starbucks's sweeter beverages are starting to catch on. One of the chain's best-selling drinks in China is the caramel macchiato, made with espresso, milk and caramel flavoring topped with whipped cream and caramel sauce. It costs about \$4 for a grande size.

On a warm summer evening at a Starbucks in downtown Shanghai, customers lined up at the counter to order mango Frappuccinos, fruit and vegetable cups and blueberry cheesecake. Warren Guo, a 30-year-old who works in foreign trade, sat on the patio and shared a piece of cheesecake with his friend David Wang, 35, who also works in foreign trade. Mr. Guo says he doesn't like coffee but comes to Starbucks because there are "many girls."

Fang Sun Yan sipped a latte with whipped cream on the patio while checking her cellphone for messages. The 23-year-old runway model started coming to Starbucks to meet friends. Now she says she's grown "a little bit addicted" to coffee and visits as often as three times a week.

Guo Shi Yuan, a 48-year-old Buddhist monk dressed in a gold robe, ordered a cup of black tea and sat at another downtown Shanghai Starbucks. He'd traveled from his nearby mountain village by train to meet another monk to discuss their faith.

"I come here because I prefer the environment more than the coffee," Mr. Guo said while music by Marvin Gaye played in the background. "It makes people feel comfortable."

Far East Brew

A look at Starbucks' moves in China:

1999: Starbucks opens its first China store in Beijing's China World Trade Center and partners with Chinese firms to expand.

2000: It opens a Forbidden City location, prompting some local backlash, and also enters Shanghai.

2003: Starbucks sues a Shanghai competitor for trademark infringement after the chain opened stores using a green-and-white logo and similar-sounding Chinese name. It later won the suit, but the defendant has appealed.



A Starbucks store in the Forbidden City, in Beijing

2004: New regulations make it easier for Starbucks and other retailers to expand in China without local partners.

2006: Starbucks buys out a large local partner and starts opening more stores in China's big cities.