Keurig Green Mountain 2015: Dynamic Capabilities and Sustainable Strategic Positioning

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It was the beginning of a new calendar year, January 2015, and senior management of Keurig Green Mountain (GMCR) gathered around the wood conference table in the back meeting room of the Vermont headquarters. Earnings had steadily increased over the past 4 years. Net Income for fiscal year-ended September 27, 2014 was $596,518,000 (see Table 1). Stock price hovered around $131 (see Figure 1). Yet, the meeting was not one of celebration; rather, it had a serious tone. Competition was intense in the tiered coffee industry. In 2012, important K-cup patents had expired exposing the company to fierce competition. GMCR stock price fell; yet, the company came back in good graces. The question on the executives' minds was could GMRC sustain its competitive position in the coming years and continue to rake in healthy returns. Or was GMCR a coaster on the top of the run. GMCR President and CEO, Michael Kelley made a statement that encapsulated the concern.

> I haven't seen a company with this kind of genuine, integrated sustainability commitment. It's one of the key elements that attracts people to us, and it's one of the elements that attracts consumers to our brands. That's really our opportunity: How do we stay in the lead and continue to stay on the leading edge. ("Green Mountain Coffee Roasters, Inc.: CEO Dialogue," 2013)

Keurig Green Mountain (GMCR) changed the dynamics of the coffee manufacturing industry when it embraced the Keurig concept of a single-serve home brewer and subsequently in 2006, acquired complete ownership of Keurig including patents protecting key components in the brewing process. GMCR sales skyrocketed as the single serve brewer became nationally renowned. The company was an innovative disrupter. Yet, competitors lurked close behind, and lead time had diminished. GMCR, a green initiator, had long been known for environmental stewardship. In recent years, competitors in the specialty coffee segment jumped on the Corporate Social Responsibility (CSR) bandwagon producing sleek CSR reports that referred to charitable donations and the alleviation of negative footprints. Fair trade became more commonplace, and coffee flavors were perfected to please the most discriminating palettes. How would GMCR continue to capture the market? Did GMCR have the capabilities to provide the company with sustainable value for decades to come?

TABLE 1
GMCR COMPARATIVE INCOME STATEMENT
KEURIG GREEN MOUNTAIN, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands except per share data)

	September 27, 2014	September 28, 2013	September 29, 2012	September 24, 2011	September 25, 2010
Net sale	4,707,680	4,358,100	$ 3,859,198	$ 2,650,899	$ 1,356,775
Cost of sales	2,891,820	2,738,714	2,589,799	1,746,274	931,017
Gross profit	1,815860	1,619,386	1,269,399	904,625	425,758
Selling and operating expenses	561,573	560,430	481,493	348,696	186,418
General and administrative expenses	307,046	293,729	219,010	187,016	100,568
Operating income	947,241	765,227	568,896	368,913	138,772
Other income (exp.), net	262	960	1,819	648	85
Gain (loss) on financial instruments, net	8307	5,513	(4945)	(6,245)	(354)
Gain (loss) on foreign currency, net	(19,746)	(12,649)	7,043	(2,912)	—
Gain–sale of subsidiary			26,311	—	—
Interest expense	(11,691)	(18,177)	(22,983)	(57,657)	(5,294)
Income before taxes	9,24 ,373	740,874	576,141	302,747	133,209
Income tax expense	326,959	(256,771)	(212,641)	(101,699)	(53,703)
Net Income	597,414	484,103	$ 363,500	$ 201,048	$ 79,506
Net income attributable non-controlling interests	896	871	872	1,547	—
Net Income attributable GMCR	596,518	483,232	$ 362,628	$ 199,501	$ 79,506
Net Income per common share-basic	3.80	3.23	$ 2.34	$ 1.36	$ 0.60
Net income per common share–diluted	3.74	3.16	$ 2.28	$ 1.31	$ 0.58

Source: GMCR 10K Reports published November 17, 2014 and November 28, 2012

FIGURE 1
GMCR 5 YEAR STOCK PRICE GRAPH

Source: Yahoo Finance, 2014

HISTORY

It was 1980, and Bob Stiller was visiting his ski condo in the mountains near Sugarbush, Vermont. Stiller and his business partner, Burt Rubin, had just sold E-Z Wider, a rolling paper company that engineered a wider, easier paper, each walking away with a cool 3.1 million (Bob Stiller: EZ Wider Maker, 1998). Stopping in a small specialty coffee shop in Waitsfield, VT, Stiller stumbled upon his next business opportunity. Little did he know, that coffee would change his life. Inspired by that rare cup of excellent coffee, he tried to roast his own beans, yet to no avail. Stiller bought the coffee shop in 1981 and built it into Green Mountain Coffee Roasters, Inc. According to Stiller,

> And this coffee was great, a different product from what coffee normally was–really good fresh-roasted coffee. And I knew that there was a huge market for this because people just didn't know what great coffee could taste like. ("Bob Stiller: EZ Wider Maker," 1998)

In 1981, Green Mountain Coffee Roasters (GMCR) incorporated and moved operations to Waterbury, Vermont the following year ("Our History" GMCR, nd). The construction of the plant was costly as was the operation of the retail stores. Hoping to reach more customers and increase sales, GMCR launched a mail-order coffee service in 1986 ("Our History" GMCR, nd). Soon after, GMCR began selling coffee on a larger scale with King as the first supermarket chain buyer. Stiller knew he wanted this company to be different and laid his savings on the line (Redfield, 2012). The first few years were trial-and-error as he envisioned GMCR competing with Starbucks as a large gourmet coffee retailer, a market that was unreceptive to newcomers. GMCR slowly evolved into a steady business; although, it had not gained the success many expected. On September 21, 1993, GMCR went public with an initial offering of $10 per share. Interest was lukewarm at best (Shiffman, 2001). The company experienced severe, post-IPO losses and began to reevaluate its business plan. Two engineers approached GMCR that year with an entrepreneurial design for a single-cup coffee brewer. GMCR embraced the innovative Keurig concept. The next years were filled with hope; although, it was not until 1995 that GMCR turned a profit ("Our History" GMCR, nd).

In 1997 an important deal with Exxon Mobil allowed GMCR to sell coffee in Exxon convenience stores. The national exposure was tremendous. GMCR coffee was not the sole coffee option as the cheaper Exxon-label coffee was available; yet, the customer showed a clear preference for Green Mountain Coffee. Many believed this was due to the marketing GMCR had carefully crafted over the years (Shiffman, 2001). GMCR was known for producing a premium cup of gourmet coffee and for its commitment to the environment. In 1997, GMCR in conjunction with Keurig issued two important patents, which would expire in 2012. This began a long history with the US Patent and Trademark Office as the compamet coffee company that delivered on its promises. GMCR began marketing and selling to the untapped office coffee market and became the first coffee roaster to offer individual K-cups for the Keurig brewer.

The company focus shifted from retail to wholesale in 1998. GMCR closed the ten remaining retail stores, and launched the customer e-commerce site. The Keurig single-cup brewer dramatically impacted GMCR's office coffee business. In the late 2000s, GMCR employed social media marketing as it had become mainstream and constituted a large part of consumer exposure to advertisements and products ("Green Mountain Coffee Roasters-Journal," 2012). Yet, GMCR intentionally spent relatively little on marketing, just 2% of total revenue, to ensure that more money could be applied to environmental causes, employees, and quality coffee ("Growth Story," 2009).

The following years brought expansion not only in physical factory space but also in brands, products, and initiatives. In 2000, GMCR entered into a contract with TransFair USA to buy and sell Fair Trade Certified coffee beans and products. In 2001, the GMCR line included 21 certified organic coffees. According to TJ Whalen, the Director of Brand and Market Development for GMCR, the expansion, "enhances the company's standing in the growing natural foods segment" ("Green Mountain Coffee Roasters Expands," 2002). In 2005, an agreement was signed with McDonald's in the northeast to serve Newman's Own Organic Coffees. GMCR decided to expand the Waterbury, VT facility by 9,000 square feet and constructed a new 52,000 square foot distribution center nearby.

GMCR acquired the remaining ownership percentage of Keurig along with valuable Keurig patents for $104.3 million in 2006 (Sanford, 2006). The companies worked in close coordination with one another. GMCR updated and expanded Keurig brewers and K-cup selection. According to Kevin Hartley, GMCR VP of Enterprise Strategy and New Business,

> In the world of closed coffee systems, we (GMCR and Keurig) have a true razor/razor blade model wherein we design and build the brewers, and we design, build and package the beverages that go in the brewers. The innovations are done hand-in-hand. (Ackerman, 2012, Powerful Pairing, para. 4)

The company products worked together. The brewer was sold at or under cost, and the K-cups, which were necessary to operate the brewer, were priced to generate a nice margin. The company remained committed to the environment, converting delivery trucks to biodiesel fuel, and using recycled/recyclable products. In both 2006 and 2007, the company was recognized as number one on the Top 100 Corporate Citizens list, being the only company to receive the honor for two consecutive years. (See Table 2).

TABLE 2
GMCR HISTORY

Important Events in GMCR History	
Year	Event
1980	Bob Stiller drank first cup of "Green Mountain" coffee in Waitsfield, Vermont.
1981	Green Mountain Coffee Roasters incorporated.
1986	Mail-order business launched.
1993	GMCR IPO; Stock opened at $10.
	Two engineers approached GMCR about developing a single-cup brewing system. Keurig is created.
1997	ExxonMobil began selling Green Mountain Coffee.
	GMCR entered office coffee service market.
1998	First order received on customer direct e-commerce site.
	GMCR closed remaining retail stores.
2006	GMCR acquired 100% of Keurig.
2006/2007	GMCR named #1 on list of "100 Best Corporate Citizens" two years in a row.
2007 2009 2010	Larry Blanford named GMCR President/CEO. Acquired Timothy's World Coffee® brand/wholesale business (Ontario). Acquired Van Houtte(Canada).
2012 2013 2014	Important license agreements with Starbucks and Dunkin Donuts. Brian Kelley appointed GMCR President/CEO. Partnership with Campbell Soup initiated. Company name change to Keurig Green Mountain.

Source: http://www.gmcr.com/Our-History.html

In 2007, an important transition in leadership occurred. Larry Blanford became the new president and CEO of GMCR. Blanford expanded the K-cup brands and established national prominence. In 2009, GMCR bought Timothy's World Coffee® brand, a wholesale business based in Toronto, Ontario. LJVH Holdings Inc., a Canadian Company that owned Van Houtte and other brands, was acquired in 2010.

The year 2011 marked the beginning of key partnerships as GMCR formed an agreement with Starbucks whereby Starbucks coffee became available in K-cups, and Keurig brewers were sold in Starbucks' locations. A similar deal was struck with Dunkin Donuts later that year. GMCR experienced dramatic growth as the Keurig brewer found its way into hotels and homes across the country. The company fought to maintain the market lead and released a new single serve model, the "Vue," in August of 2012. At that time, GMCR sourced and sold more than 30 brands and 200 varieties of coffee, teas and other beverages (Ackerman, 2012).

In December of 2012, Brian Kelley was lured away from Coca-Cola and became president and CEO of GMCR bringing energy to the company. GMCR announced an agreement with Campbell Soup to add soup to the now 250 plus Keurig beverage offerings in September. In May of 2013, GMCR expanded the initial partnership with Starbucks with a minimum five year agreement. At the annual shareholder meeting in March of 2014, shareholders approved a new company name - Keurig Green Mountain Inc.

Kelley stated,

> The name Keurig Green Mountain brings together our two strongest brands, Keurig and Green Mountain Coffee, into one single and powerful corporate identity that symbolizes the strength of our business and the unity of our team while also recognizing our strong heritage. (GMCR Changes Its Name, 2014, para. 2)

By January 2015, GMCR employed over 6600 employees and 500 engineers and scientists.

THE COFFEE INDUSTRY

The Coffee Chain

Coffee was the world's second most traded commodity behind petroleum. The United States was the largest importer of coffee, and Brazil was the dominant coffee producer followed by Vietnam and Indonesia ("Coffee Roasted," 2013). Coffee was known for its price volatility. The process from harvest of the bean to retail was complex and stretched from the poorest regions to wealthy, cosmopolitan communities.

> Coffee is a vital part of the integument that binds us to each other and with the planet. However, coffee has also been markedly different than most global products because there has been a lasting dichotomy between where it is primarily produced (in the so called third/developing/global Southern world) and consumed (the first/developed/global Northern world) (London, 2012, p. 1055).

Coffee beans changed hands many times before reaching their final destination. A conventional global coffee commodity chain encompassed several constituents -the grower, producer association, global trader, roaster and retailer (see Figure 2).

Grower

Coffee cultivation took place on both small family farms and large coffee plantations in undeveloped countries. Specialty coffee was primarily grown on small farms of less than three hectares. Many coffee farm families lived in poverty and were at the mercy of weather and global supply/demand to make ends meet. Margins were small, and the work was tough. Coffee "cherries" were often picked by hand. Growers would "separate the pulp of the front from seeds, sift out the husks, and wash and dry the coffee beans" (Whalen, 2003). Planting, tending to the crops, timely harvest and sale to the local producer association comprised the coffee farmer's duties. Harvest lasted only a few weeks yet impacted the entire year of the farmer.

FIGURE 2
THE COFFEE COMMODITY CHAIN

Producer	
Private Intermediary **Processing Plant**	
Local Exporter	*Producing Country*
------------------------------	------------------------------
International Trader	*Consuming Country*
Roasting Company	
Retailer	
Consumer	

Source: Anna Milford, Coffee, Co-operatives and Competition:
The Impact of Fair Trade, Chr. Michelsen Institute, 2004.

Producer Association/Marketing Board

Many non-farm activities like milling and buying were part of this stage of the chain. Local traders brought farmers' beans to the market. The green coffee beans were classified and graded. Processing could be left to the grower or might be incorporated in the producer association. Wet processing resulted in mild Arabica coffee; whereas, dry processing produced a more bitter flavor of coffee.

Global Trader

Both exporters and importers of the commodity were considered traders. They moved beans from the producing countries to the consuming countries and dealt in volume. Concentration was tight with three large entities (Volcafe holdings Ltd., Neumann Kaffee Gruppe AG, and Ecom Agroindustrial Corp Ltd.) dominating this aspect of the coffee business (Slob, 2006).

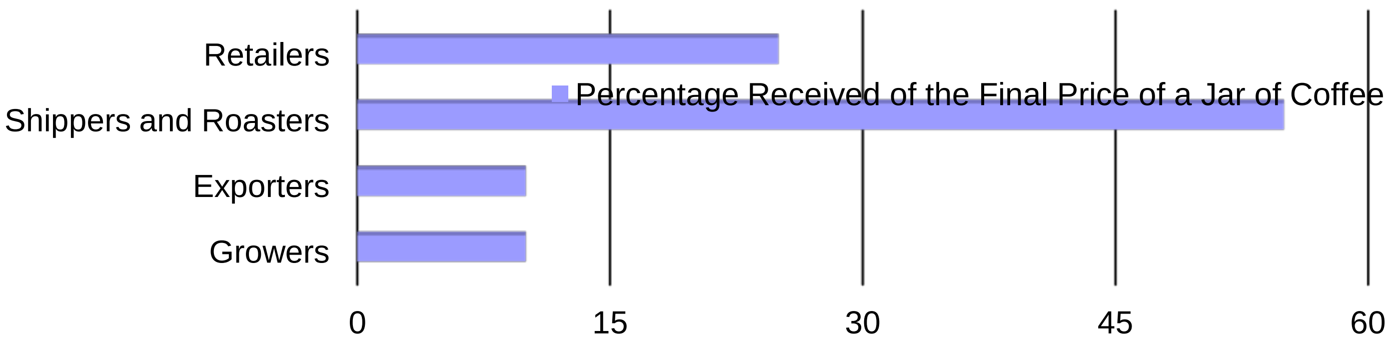
Roaster

Roasting was a critical factor in determining coffee's taste as flavor and aroma were added during the roasting process. As moisture was eliminated from the bean, flavor was released. Roasters transformed harvested green beans into the brown beans sold in retail stores.

> Because the changes in beans occur quickly, the roastmaster must keep a careful eye on the batch to achieve the desired flavor in the beans...and roast the coffee beans to a color consistent from the inside to the outside of the bean as well as throughout the batch ("Coffee Roasted," p.426).

The darker the bean, the stronger the flavor. Beans were quickly blended, ground, brewed, freeze-dried and delivered to retailers. Different blends were created and packaged for retail. Roasters earned the largest percentage of the retail price enticing some growers to become roasters (see Figure 3). Roasters included small boutique special origin outfits as well as multinational deep-pocket corporations. "The high promotional costs in brand development and marketing have originated the rise of a small number of omnipotent multinational roasting and marketing companies. These firms manufacture instant and ground coffee, and compete with each other on the basis of branding backed by large expenditure on advertising in the coffee consuming countries" (Slob, 2006). Mega roasters included Nestle SA, Kraft Foods Inc., Proctor and Gamble and Sara Lee Corporation.

FIGURE 3
COFFEE VALUE CHAIN REVENUE BREAKDOWN



Source*:* Ransom, D. (2006) *The No-Nonsense Guide to Fair Trade.*
Rotherham: New Internationalist. p. 20.

Brewer/Retail

Coffee was sold in a variety of forms including packaged ground coffee, packaged coffee beans, soluble (instant) coffee, K-cups, and brewed/ready to drink coffee. The end consumer was the customer who purchased coffee to retail or brew. Significant coffee retailers included Walmart and Krogers among others. Some brewers of coffee, namely Starbucks and Dunkin' Donuts, retailed packaged coffee as well. The end-consumer had ample control and flexibility as to the grind of the bean, the type of coffee and the amount of coffee used and increasingly was defined by consumption location—retail, home or office.

The coffee and tea industry seemed lucrative and ripe with opportunity; yet, serious threats existed. Coffee and tea manufacturers were extremely dependent on natural resources—coffee beans, tea leaves, herbs, spices, etc. Insects and the weather posed as major threats to coffee producers and sellers due to the direct effects on the quality and quantity of coffee beans harvested. Diseases like coffee rust and pests like the berry borer wreaked havoc on coffee farms. In order to produce a profitable crop of beans, a coffee tree must be healthy for 10 years, meaning growth without disease or bug infestation (Neville, 2008). The Arabica-bean producing countries of Brazil and Columbia had experienced significant supply disruptions in the past attesting to the crop's sensitivity to exposure (Harrington, 2011)

Inconsistent cash flow with peaks in the winter and lulls in the summer presented another challenge; however, many companies offered iced coffee and tea to combat the seasonality. Luckily, premium coffee was inelastic to fluctuations in the economy and price increases. Even in a period of economic downturn, individuals were willing to spend discretionary income on luxury coffee. Premium coffees were often high-quality, mild varieties of Arabica coffee grown in microclimates. Arabica coffee accounted for about 60% of the world's crop, and fetched higher prices. The Arabica beans were less acidic with a delicate flavor; whereas, Robusta coffee was a hardier crop, with a more bitter taste. (NCA) It seemed that premium coffee was a necessary treat. According to a recent coffee report, "Despite the fact that virtually all of the major coffee companies have raised prices significantly in the last nine months, some repeatedly, consumers still are willing to pay more for the Arabica coffee" (Harrington, 2001, Major Coffee Companies, para. 4).

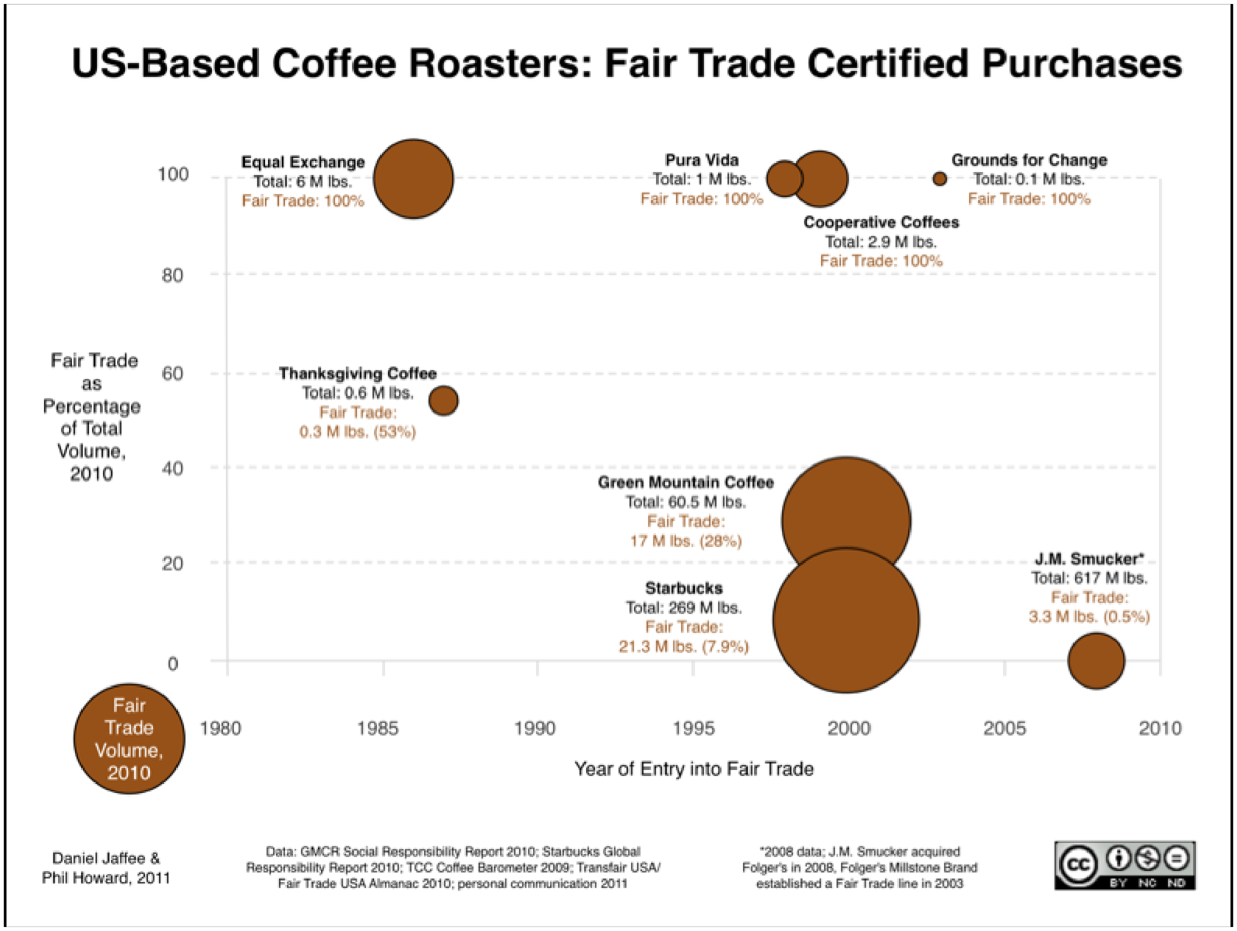
The Fair Trade Movement

"There is little debate that Fair Trade contracts have played a critical role in providing a safety net for peasant farmers and stimulating the growth of producer organizations amid a global coffee crisis between 2000 and 2004" (Wilson, 2013, p. 179). After the collapse of the ICA (International Coffee Agreement) in 1989, coffee prices fell to a 30 year low in the first four years of the 21st century wreaking havoc on the livelihood of vast numbers of coffee farmers. The global coffee crisis resulted from deregulation and increased coffee supply relative to demand. Vietnam, encouraged by the International Monetary Fund, had cultivated large quantities of Robusta coffee. There was a substantial increase in coffee production from Brazil. The world market price of high quality coffee dropped due to the oversupply of low quality coffee. This resulted in economic devastation for coffee producers. Fair trade specification provided the opportunity to support small farm producers as well as consumer-desired transparency. The coffee chain for fair-trade coffee was simpler than conventional coffee, eliminating some middle players, and provided farm workers with a guaranteed price for their labor.

Fair Trade Certified became the fastest growing sector of coffee imports in the United States with a 25% growth rate from 2007 to 2008 and offered a venue for the millennial generation to engage in what was right ("Where Did It All Begin," 2011). The "trend-setting, if not free-spending group of 95 million Americans, born from 1982 to 2004, live and breathe social media and are broadly convinced that doing the right thing isn't just vogue, but mandatory" (Horovitz, 2013, p. 1A–2A). In the early 60's, Fair Trade began as a small movement by business owners in the US whereby stores carried goods which were "fairly traded" with the producers--usually impoverished or underprivileged people in developing countries--to ensure a fair market and economic growth. The idea became known as, "Trade Not Aid," referring to the need for capitalist growth in underdeveloped economies to promote long-term change not short-term aid ("Where Did It All Begin, 2011). A product certification system identified products in compliance with environmental, labor and developmental standards ("Fair Trade Certification," 2013). Fair Trade standards included economic benefit for all parties, traceable and beneficial trade, and environmental restrictions such as no GMO's or harmful agrochemicals.

GMCR joined the organic movement in 1997 offering the pure Organic Peruvian line of coffee ("Our History," 2012). In 2000, GMCR signed a contract with TransFair USA to certify a line of Fair Trade organic coffees, and Starbucks quickly followed suit as it established a licensing agreement later in 2000 (See Figure 4). The two companies battled back and forth searching and seizing new ground with eco-friendly coffee and related products. "Fair Trade CertifiedTM organic coffee experienced greater growth than conventional coffee in 2010. In fact, organic coffee grew from 47 percent to 62 percent of the total import volume in 2010, amounting to over 65 million pounds" (Fair Trade Certified Coffee, 2014). "Fair Trade has been decisive in protecting small scale farmers against some of the vagaries of market participation within a highly oligarchical and non-democratic agro-food network; however, it is also no magic bullet" (Wilson, 2013, p. 179). According to research, "Although higher prices are paid to producers for organic fair trade coffee than for conventional or fair trade coffee, the producers' share on the final retail price is substantially lower in the certified chains than in the conventional chain" (Kieman, 2010, p.ii).

FIGURE 4
US-BASED COFFEE ROASTERS - FAIR TRADE CERTIFIED COMPANY ENTRY



Source: Jaffee, Daniel, and Phillip Howard. "Visualizing Fair Trade Coffee." *Michigan State University*. Michigan State University, Dec. 2011. Web. 10 June 2013.

National Growth

Whether it was to fuel a long, hard night or to warm the body on a cold day, coffee had long been a staple of the workingman. As the population multiplied, so had the number of coffee drinkers. According to the National Coffee Association (NCA), from 2009 to 2011, the percentage of adults in the US who drink coffee increased from 54% to 58% (Harrington, 2011). This created a large customer base for the coffee and tea manufacturing industry (NAICS code: 311920), which brought in around 9 billion annually in the United States (70 billion globally) with only about 300 companies comprising the industry in 2012 ("North American Industry," 2012). While the number of companies in the coffee and tea manufacturing industry was small, 90% of the revenue was concentrated in an even smaller number of companies—only 50. Some of the most recognizable names included Green Mountain Coffee Roasters, Kraft Foods (Maxwell House), and JM Smuckers Company (Folgers) ("Coffee and Tea," 2012). Due to the concentrated market share, large annual revenue, and small number of companies, the industry was capital-intensive.

As the number of coffee and tea manufacturers committed to environmental practices increased, demand and opportunity for gourmet coffee surged. The average consumer no longer sought a plain cup of coffee. Over 30 million Americans consumed a gourmet or specialty coffee or tea per day. In 2012, according to the National Coffee Association, gourmet coffee represented 40% of the coffee market in the United States (NCA, 2013). This presented a substantial up-and-coming market for manufacturers. The large percentage could be partly attributed to the increase in specialty coffee shops and coffeehouses across the nation.

COMPETITION

Starbucks

As a prominent provider of gourmet coffee concerned with environmental stewardship, Starbucks proved to be a fierce competitor. The coffee giant began as a single store in Seattle in 1971 at Pike Place Market. As of 2015, Starbucks had over 23,187 stores in 64 countries, including 12,973 in the United States, 1,897 in China, 1,550 in Canada, 1,088 in Japan and 927 in the United Kingdom. It was the largest coffeehouse company in the world. Starbucks capitalized on GMCR's expiring patents by releasing its own home-brew, single-serve machine, Verismo, in 2012 to make not only coffee but espresso as well ("Our History" Starbucks, 2012).

The J.M. Smuckers Company (Folgers, Dunkin' Donuts, and Millstone)

The J. M. Smuckers Company was a leading marketer and manufacturer of a family of brands including several retail packaged coffee labels. Dunkin' Donuts Brand was licensed to The J. M. Smuckers Company for packaged coffee products sold in mass merchandisers and grocery stores. In 2008, Smuckers acquired Folgers Co., a Proctor and Gamble (P&G) entity that had become the number one coffee manufacturer in the United States. Millstone Coffee Company was included as part of the Folger acquisition. Folgers expanded its coffees to include gourmet flavors and even a coffee manufactured to be easy on the stomach to keep up with demand and changing preferences ("Explore the Rich Folgers History," 2013).

KEURIG

The Danish word "Keurig" meant excellence. It seemed to be the perfect name for a company founded by two engineers that created an innovative, industry-rocking single serve brewer. In the early idea stage of Keurig, GMCR invested in the company although GMCR did not have a controlling interest. Originally, the brewer was designed for the office market niche, but after the company sold 10,000 commercial brewers in 2002, the realization hit that this idea had unbounded potential. Plans for the development of an in-home brewer began.

In 2006, Keurig became a 100% owned subsidiary of GMCR and served as a growth driver for the company. In 2010, Keurig provided $41.2 billion in revenue, which represented 88% of GMCR revenue (McGinn, 2011). Keurig practically monopolized the single serve, in-home coffee brewer market with few competitors coming close with espresso machines. GMCR estimated that, in 2012, more than 378,000 business offices and 10.8 million households owned a Keurig home brewer (Banham, 2012). Keurig kept ahead of the competition with cutting-edge products. Full of talented engineers engaged in research and development, the company held an air of secrecy. Dick Sweeney, the manager of quality control stated, "You have to understand, we're a one trick pony." Sweeney was referring to the protectiveness Keurig displayed over new ideas and upcoming products (McGinn, 2011, p. 7).

PATENTS

A patent was defined by the US Patent and Trademark Office as:

> …an intellectual property right granted by the Government of the United States of America to an inventor "to exclude others from making, using, offering for sale, or selling the invention throughout the United States or importing the invention into the

> United States" for a limited time in exchange for public disclosure of the invention when the patent is granted.

GMCR strategically employed patents as a tool to protect and exploit advances and inventions. Keurig issued many patents on items such as filters and electronic equipment due to the heavy emphasis on research and development (R &D). As of January, 2014, GMCR had issued over 265 patents globally and had over 175 patents pending ("Who We Are," 2014).

Two important company patents expired on September 16, 2012—patents 5,325,765 (765) and 5,840,189 (189). The first patent, 765, protected much of the basic K-cup concept including its shape. The patent was issued on July 5, 1994 and expired 18 years later. Although 765 was important, it was not the patent that would allow the competition to begin production of generic K-cups. Patent 189 protected an early filter used inside the k-pod. This patent was issued on November 24, 1998; yet, a sentence in patent 189 linked it to 765 as a divisional patent meaning it (189) would expire when 765 expired.

David Einhorn of Greenlight Capital rallied against GMCR in a presentation at the Value Investing Congress in New York City. He indicated the company was tremendously overvalued. Einhorn specifically cited the September 2012 expiration of two critical K-cup (Keurig cup) patents alluding to the "likely" loss of GMCR's lead over industry competition. According to Einhorn, GMCR would be inundated with competition in the K-cup market meaning declining sales and the loss of high K-cup margins.

GMCR president and CEO Larry Blanford responded to the speculation stating, "Patents are granted to inventors to give them a head start. They are not forever. We continue to file for patents, but that's not how we really built the business" (Jargon, 2012). According to Blanford, patents served the company by providing necessary lead-time to carefully construct a lasting foundation.

GMCR reassured the public that patent expiration would not have a substantive effect on profitability, as the patent-protected filter was an older-generation filter that had not been used for years. GMCR had developed a more sophisticated filter that produced a richer cup of coffee.

LEADERSHIP

Robert P. (Bob) Stiller (1981-2006)

Bob Stiller was the idea man, the creator of GMCR. According to Liz Robert, who served on boards with Stiller, "He's a big-picture thinker. He comes across as being maybe a bit eccentric, but I marvel at his intuitive ability to understand what's going on in the market" (Marcel, 2007, para. 37). After graduating from Parsons College in Iowa in 1965, Stiller began work in the Comptroller's Office at Columbia University. His first major success was selling rolling paper on the drug-laden Columbia University campus in the early 1970s. He partnered with Burt Rubin and formed an innovative rolling paper company by the name of E-Z Wider. The rolling paper was composed of wood pulp or cellular-based paper that burned slower. Most rolling paper at the time was manufactured for cigarettes and was much narrower than what small-leafed marijuana needed. His company doubled the width of competing brands while preventing tears. The rolling paper was distributed in head shops, tobacco and candy distributors. The company was a success; yet, Stiller and Rubin had differences and sold the business in 1980.

Stiller quickly moved to his next venture, the purchase of a small coffee company in the mountains of Vermont. In the 2011 Annual Report, Stiller stated,

> When I founded Green Mountain Coffee Roasters, Inc. (GMCR), I did it with the belief that embracing a business model that truly cares about its employees, its stakeholders and the world, is the right thing to do and drives the best financial results. ("GMCR 2011 Annual Report," 2011, Chairman's letter, para. 1)

In 2001, Forbes magazine named Stiller entrepreneur of the year (Neville, 2008). Bill Davis, a member of the GMCR Board of Directors, indicated that the strength of Stiller's leadership was "...his ability to set a strong foundation built on social responsibility, strategic planning and fundamentally strong economics" (Simmon, 2003, para. 16). In 2007, Stiller stepped down as CEO and became Chairman of the Board for GMCR. He was persistent in his efforts to encourage quality and social responsibility. He stated, "One of the things I try to convey to other businesses is that, by having a social and environmental mission, you are, I feel, guaranteed more success and the likelihood of better profitability" (Simmons, 2003, para. 31).

Lawrence J. (Larry) Blanford (2007- 2012)

In 2007, when Blanford was appointed President and CEO of GMCR, he remarked,

> Bob Stiller and Green Mountain Coffee have set the gold standard for being a public company that is financially successful and an outstanding corporate citizen. It will be a privilege to lead this Company to the next level of growth in the coming years, while continuing to work with Bob to support the Company's unique culture and expand upon its commitment to environmental and social initiatives. ("Green Mt. Coffee Names New President," 2007).

Blanford had deep appreciation for the founder and the history of the company. He believed social responsibility was a key area of growth and stated, "It's the essence of what differentiates this company" ("Corporate Social Responsibility," 2010, para. 1) Blanford came to Green Mountain with rich and varied experience. He had served as CEO of Royal Group Technologies Ltd, president and CEO of Philips Consumer Electronics North America, and as President of Maytag Appliances and Maytag international. At Proctor and Gamble, he was responsible for Folgers Coffee. According to Stiller, "Larry's success lies in his strong values, strategic thinking, tacital execution, and excellent track record of growth" (Green Mt. Coffee Names New President," 2007). It was believed that Blanford could take the winning formula to the next level.

Blanford thought there was a tremendous synergy between GMCR and Keurig. He stated, "The brewer is introducing people to GMCR and GMCR is introducing people to the brewer" (Marcel, 2007, Future Plans, para. 6) He aligned the two distinct businesses to yield optimal results. GMCR was a food science, nutrition business with domestic manufacturing; yet, Keurig was a software engineering business that pushed the boundaries of science and technology with manufacturing in China (Blanford, 2011). Blanford purposefully kept the businesses physically separate; yet, created value at their intersection. Once the Keurig lines became successful, Blanford forged strategic alliances with notable companies like Starbucks, Dunkin Donuts, and Smuckers.

Brian P. Kelley (2012 -)

In December of 2012, Brian Kelley stepped into the GMCR president/CEO shoes after leaving Coca-Cola Refreshments USA, Inc. as Chief Operating Officer. Young and dynamic, Kelley brought valuable experience and knowledge from the beverage industry. Coca-Cola had a diverse portfolio of products, selling much more than soda, including orange juice and PowerAid.

Kelley began his career at Procter and Gamble in 1983 after completing an Economics degree at College of the Holy Cross. He had worked as a senior executive at General Electric and North American Van Lines, Inc among other companies. He entered GMCR at a time of intense competition and intended to maximize the benefits of the GMCR- Keurig connection. He stated,

> It's really only the last six years that these two (GMCR and Keurig) have co-existed and integrated, and that's where all the magic has been made. . . . Over time we have a simple mission, which is to get a brewer in every home and in every place of work, and then have a beverage for every occasion. We know that there's opportunity for us to use the

> Keurig brand name and platform to be able to offer more beverages than what we offer today.” (Kowitt, 2013, para. 6, 14)

He created growth opportunities in new channels and new brewer technologies. Kelley expanded the GMCR management team, adding Robert Ostryniec as chief product supply officer and Lori Tauber Marcus as brand and product marketing manager (Detar, 2013). In 2013, he announced GMCR had partnered with Campbell Soup. According to Kelley, "Running a big $4 billion company is different than running one half its size. There's operational challenges to it, but it's all about growth" (Bullard, 2012, para. 14).

SOCIAL RESPONSIBILITY

Investment in Socially Responsible Companies

There was increasing interest in socially responsible companies. Investors were starting to understand that they could affect social change through investment choice. “According to a new study by US SIF (Social Investment Foundation), values-based investing (VBI) accounts for 3.74 trillion, or roughly one in every eight to nine dollars under professional management. That is up 22% from 3.1 trillion in the organization’s 2010 report” (Wolfe, 2012). Financial return and social change were no longer viewed as mutually exclusive concepts. According to Chief Investment Officer Christopher Wolfe at Merrill Lynch, “It is the ability to maintain a healthy balance between helping the world and looking after one’s own best interests that has helped Values Based Investing (VBI) move into the mainstream” (Wolfe, 2012). Increasingly, the 21st century investor and consumer desired more than short-term benevolence. According to Certified Financial Planner Darren Zagarola “It is more about identifying investments that are there to help us into the future, not just provide immediate short-term benefits” (Zagarola, 2012).

The consumer likewise was enticed by corporate social responsibility. According to research by the NPD Group and Civic Science, when consumers were asked how important a company’s social consciousness was in determining where they shop and what they buy, 74% stated that it was either “very” important or “somewhat” important (Horovitz, 2013). Marshal Cohn, chief retail analyst at the NPD Group, relayed that social consciousness was “a powerful marketing tool for brands to use to separate themselves from the competition” (Horovitz, 2013, Front Page sec. 1A-2A). Conducting business with a socially-conscious company made the consumer feel more engaged in making a difference

Early Initiatives

From the beginning, GMCR was committed to environmental stewardship especially in the form of waste reduction and responsible energy use. In 1983, only two years after the company’s incorporation, employees began composting used coffee grounds. GMCR established the Employee Environmental Committee to lead the company on conservation issues in 1989. It was through this committee that GMCR began its recycling program. One year later, GMCR created an Earth-Friendly Coffee Filter, one of the first alternatives to the traditional dioxin-bleached filter. The filter was bleached with oxygen instead of dioxin, a known carcinogen (“Bleach, Dioxins,” 2008). The company continued to conduct business with sustainability in mind, and the public took notice. In 1997, 3M gave an engineering accommodation to GMCR for making the first biodegradable coffee bag.

Later Initiatives

Whether it was compostable cups or biodiesel delivery trucks, GMCR made a commendable effort for every part of the business to be environmentally sustainable and documented its efforts in an official CSR report in 2005. In 2007, The Specialty Coffee Association of America awarded the Sustainability Award to GMCR for the use of sustainable recycled cups, which were estimated to have saved over half a million pounds of petrochemicals from entering landfills (Flitter, 2012).

One of the largest forms of social responsibility practiced by GMCR was its commitment to promote and provide fair trade and organic coffee, which accounted for around 20% of total revenue via 45 different fair trade certified offerings (Green Mountain Coffee and Environmental Responsibility, 2012). According to Lindsey Bolger, GMCR Senior Director of the Specialty Coffee business unit, "We began as one of the first roasters in the country to offer Fair Trade Certified coffees in 2000, and we're now engaged with stakeholders to ensure the growth of the fair trade movement into the future" (Newman, 2012). GMCR was named the world's largest purchaser of Fair Trade Certified coffee in 2010, 2011 and 2012 by Fair Trade USA. Through the years, more than 13 million from GMCR Fair Trade Certified coffee purchases had been delivered to coffee farmers ("Green Mountain Coffee Roasters. Specialty Coffee," 2013)

In September of 2012, GMCR announced that an education initiative featuring videos by Y&R New York informing consumers on Fair Trade practices, would be featured on Green Mountain's Facebook page, in mainstream publications and multi-media websites. In one video, a farm worker relayed how premiums from the fair-trade program enabled him to send his children to school. An on-site Green Mountain employee explained that through direct relationships with small farmers, GMCR could identify farm sites that yielded the most desirable coffee (Newman, 2012).

SHARED VALUE INITIATIVES

Through economic and social initiatives, GMCR exercised care for the coffee supplier communities. Annually, the company donated 5% of pretax earnings to economic and social projects. As of 2010, GMCR had funded over $700,000 in private grants for food concerns in its coffee communities in Nicaragua (Sanderson, 2012). In 2012, GMCR spent 10 million in Nicaragua to correct supply-chain issues such as education, irrigation, and food-chain issues (Sanderson, 2012). By bettering suppliers' situations, GMCR not only helped the suppliers, but fortified company supply-chain resiliency.

Blanford encouraged GMCR to employ sustainable supply management. GMCR had more than 7,000 suppliers. As stated on the company website, GMCR believed, ". . . a sustainable coffee supply chain means that there is sufficient water not just for coffee to grow, but also for coffee growers to thrive" ("Sustainability," 2009). GMCR focused on two distinct water initiatives. The first was to provide portable water to communities that had never previously had access to a water source, or were suffering from water quality issues. In Nicaragua, GMCR brought aqueducts—a type of bridge to transport water over impediments—to communities without in-home water. The second initiative was to install drip irrigation in coffee-growing communities to produce a better crop by increasing the quality of the coffee bean, and to extend the growing season. Drip irrigation systems gave the community more crops from which to gain food for consumption.

Coffee community food supply was of grave concern. In 2007, GMCR and the Center for Tropical Agriculture conducted research on coffee farming families and "learned that more than two thirds of farmers interviewed in Nicaragua, Mexico and Guatemala experienced three to eight months of extreme food scarcity annually" (Revkin, 2012). This period became known as "los meses flacos" (the lean months) during which low food supply caused community farmers and families to eat less, eat poorly, or to borrow on future profits creating a cycle of debt. Farmers would grow, harvest, and sell the coffee beans, relying on that sale to get them through the year; yet, funds and food would run low causing serious fluctuation in the health and well-being of the community. Coffee Trust and GMCR sponsored a documentary, "After the Harvest: Fighting Hunger in the Coffeelands," to enlighten the public about the plight, and develop potential solutions. According to Rick Peyser, GMCR Director of Social Advocacy and Supply Chain Community Outreach, "Food security in coffee communities is one of our top priorities, and this film has raised awareness of this vital initiative" ("Local Film," 2012).

GMCR paired nonprofit organizations with coffee farming communities to educate the communities on food storage, crop diversification and family gardens allowing a healthier supply of food year round. GMCR funded over 18 million to projects that aided these communities ("Sustainability Report Fiscal 2012"). According to Mike DuPree, VP of Corporate Social Responsibility at GMCR,

> Some were taught to farm fish, cultivate mushrooms and produce organic honey for personal consumption and to sell in local markets. They were educated on food preservation techniques to make the (literal) fruits of their labor stretch further. We have seen diets that once consisted of primarily beans and rice shifting to include nutrient-dense fruits and vegetables. Balanced nutrition is leading to improved energy levels, heightened productivity and stronger immune systems–and happier, healthier individuals means stronger communities. (Revkin, 2012)

In the Aceh province of Indonesia, a source of company Fair Trade Certified coffee for over 10 years, GMCR partnered with the nonprofit organization Save the Children to support the LINK (Livelihoods and Improved Nutrition for Kids) project. Asnaini, an Indonesian mother of three who received vegetable seeds and education on composting, fertilizing and pest control through the project, commented,

> Through the home gardening program, I can provide my children more easily with healthy, nutritious food and also have a more consistent additional income which I can use to buy my children's school uniform and supplies." ("Green Mountain Coffee Roasters, Inc. Pledges," 2012)

The 2012 GMCR CSR Report summed it up stating, "Each step on the long road from tree to cup gives us an opportunity to create better coffee, and a better world" ("GMCR Annual Reports," 2012).

OPERATIONS

Keurig Green Mountain experienced great success since Bob Stiller fell in love with that flavorful coffee in 1980. Upon full acquisition of Keurig, GMCR expanded rapidly. The tight hold on the single serve coffee market led to increased revenue. From 2010 to 2013, net income grew from $79,506,000 to $484,103,000, a tremendous increase over 3 years. The stock price hit a high in 2011 peaking over $100 per share (See Figure 2). Share price at the end of fiscal year 2013 closed at $75 per share. By January of 2015 the stock had increased to $131 per share. The rapid growth of the company from a small coffee retailer to one of the largest suppliers of coffee and manufacturers of brewers in the single-serve, at-home market placed GMCR in the spotlight. Would the market reign continue? Were capabilities woven in the fabric of the company to enable continued vitality and renewal?

KEURIG GREEN MOUNTAIN 2015
DYNAMIC CAPABILITIES AND SUSTAINABLE STRATEGIC POSITIONING

INSTRUCTOR'S MANUAL

CASE OBJECTIVES AND USE

This case is best taught in an undergraduate or graduate Strategic Management class to expound on the importance of dynamic capabilities to sustain competitive positioning in a complex, competitive industry. Keurig Green Mountain (GMCR) differentiated itself and maintained brand awareness and distinction by sensing, and seizing opportunities in the coffee roasting and brewer manufacturing businesses. GMCR's capability to explore beyond organizational boundaries and to embrace organizational change enabled the company to maintain resilient relevance. An unbroken entrepreneurial spirit and strong commitment to r&d were embedded organizational characteristics or "microfoundations" deeply rooted in the company history.

The case facilitates student understanding of the coffee value chain—the multiple constituents and complexity. Dynamic capabilities serve as a source of renewal for the company. As competitor differences shrink and become ubiquitous, there is need for exploration and change to sustain strategic positioning. The study provides introspection on the critical role of executive leadership to cultivate organizational change capability. GMCR executive leadership instilled foundational organizational characteristics to support capability development in essence reinventing its relevance in the marketplace. GMCR's dynamic sustainability initiatives, which evolved from simple environmental measures to sophisticated shared value initiatives, illustrate the possibilities dynamic capabilities enable.

CASE SYNOPSIS

The rapid growth of Keurig Green Mountain (GMCR) from a small coffee retailer to one of the largest coffee suppliers and brewer manufacturers in the single-serve market placed GMCR in the public spotlight. In 2006, GMCR acquired Keurig and began offering a ground-breaking product, a single-serve, at home coffee brewer. Company success was dramatic as it experienced soaring profits from increased sales. The strategic acquisition of Keurig and valuable patents gave GMCR an edge on the competition; yet, important patents expired in 2012. Competition was fierce in the fragmented industry. The value chain was complex and stretched across continents. What would enable GMCR to keep the lead, to continually differentiate and reinvent itself?

Larry Blanford, former president and CEO of GMCR, believed the company was built on a sustainable foundation—something more than patents and technology. What was the company built on? What allowed GMCR to sense and seize opportunities in the marketplace? What role did executive management play in that process?

RECOMMENDED READING

Kaplinsky, R. and M. Morris. (2001), A Manual for Value Chain Research, Retrieved from http://www.ids.ac.uk/ids/global/.

Teece, D.J. (2007, August 8). Explicating dynamic capabilities: The nature and microfoundations of (sustainable) enterprise performance. *Strategic Management Journal*, 28, 1319-1350.

Porter, M.E. & Krame. M.R. (2011, January/February). Creating shared value. *Harvard Business Review,* 89(1/2), 62–77.

RESEARCH METHODOLOGY

The case was written using secondary sources including journals, newspapers, reports, and books.

DISCUSSION QUESTIONS

1. A defining characteristic of the coffee industry was the complex value chain. (a) Identify and describe the key actors and their placement on the coffee chain. (b) Where was value created on the chain? (c) How was GMCR positioned on the chain?
2. In the *Strategic Management Journal,* David Teece wrote on the importance of "dynamic capabilities" to sustain competitive advantage. (a) Define what is meant by the concept "dynamic capabilities". Identify two "dynamic capabilities" at GMCR. (b) Describe the "microfoundations" that facilitated capability development.
3. According to Teece, the role of leadership was instrumental to the development of organizational change capability. Identify how GMCR leaders - Robert (Bob) Stiller, Lawrence (Larry) Blanford, and Brian Kelley contributed to the establishment and nurture of capabilities at GMCR.
4. GMCR's sustainability initiatives evolved from simple environmental measures to sophisticated shared value initiatives. This progression exemplified the adaptation and movement that dynamic capabilities foster. (a) Track the progression of sustainability initiatives at GMCR. (b) Porter and Kramer introduced the concept of "Shared Value" in *Harvard Business Review*. Define the

concept of Shared Value? How was Creation of Shared Value (CSV) different from Corporate Social Responsibility (CSR)?

TEACHING PLAN

The Instructor's Manual is designed to promote a deeper, level of knowledge with each question. Ideally, one class period (1hr 20 min.) could be used to cover case question 1, a second class period for questions 2 and 3, and a final class period to discuss content in question 4. Question 1 provides an overview of the commodity coffee through a global value chain perspective. Students note the number of actors involved in the commodity chain as well as the consuming country orientation of coffee. Students understand Keurig Green Mountain's ideal position on the chain. Question 2 allows the students to explore Teece's theory of dynamic capabilities. GMCR's dynamic capabilities acted as the deep roots of the company producing new shoots of growth. Question 2 feeds directly into question 3 as executive management had a critical role in the creation and refinement of organizational dynamic capabilities. Question 4 provides introspection on the link between dynamic capabilities, organization evolvement and leadership by stepping through GMCR's progressive movement in sustainability initiatives. Question 4 reinforces a key take away from Question 3 discussion—the necessity for different types of leaders as an organization cycles through stages. Proposed discussion and exercises are provided in the answers to the discussion questions. A collaborative, participative methodology is suggested with designated readings to be completed before class discussion.

Ideally, students walk away from the case experience with a clearer understanding of dynamic capabilities and their relevance in a competitive, changing environment. As differentiation strategy matures, new momentum is needed to sustain strategic significance. The exploration capability and the organizational change capability enabled Keurig Green Mountain to thrive. As students chronicle the transition of GMCR sustainability measures from simple green action to sophisticated shared value initiatives, they note dynamic capabilities provide key organization vitality. They discern between core concepts, CSR and CSV, and acknowledge the importance of leaders in the creation and adaptation of an organization's competitive advantage.

ANSWERS TO DISCUSSION QUESTIONS

1. A defining characteristic of the coffee industry was the complex value chain. (a) Identify and describe the key actors and their placement on the coffee chain. (b) Where was value created on the chain? (c) How was GMCR positioned on the chain?

1(a) A thoughtful way to initiate case discussion would be with the value chain concept. By focusing on the Kaplinsky and Morris global value chain concept, students will understand the diversity of actors as well as the link between producers and buyers on the chain. According to Kaplinsky and Morris, a value chain may be defined as the interlink between producers, intermediaries and retailers in the production of an end product. The professor might ask class members to identify core constituents on the coffee chain. Students will identify many of the constituents in the diagram below (See Figure 1) (labeled in black) and pair the actors with descriptions provided in the case (labeled in blue).

FIGURE 1
THE COFFEE COMMODITY CHAIN

Producer (Grower)

Private Intermediary (Marketing Board/Producer Association)

Processing Plant

Local Exporter (Global Trader)

Producing Country

International Trader

Consuming Country

Roasting Company (Roaster)

Retailer (Brewer/Retail)

Consumer

Source: Anna Milford, Coffee, Co-operatives and Competition:
The Impact of Fair Trade, Michelsen Institute, 2004. Modified by Rebecca Treadway 03/14.

1(b) "Over the last number of decades, agricultural commodity markets changed from producer to buyer-driven chains that are regulated by actors in consuming countries" (Kieman, A. and Beuchelt, T., 2010). The Global value chain for coffee was buyer-driven. Value was added along the chain; yet, roasters increasingly received the highest percentage of the retail price of a can of coffee (refer to Exhibit 5 in the case). Farmers received a much lower percentage of retail coffee price and under fair trade received a declining percentage of specialty coffee retail.

1(c) GMCR was clearly a "roaster" on the chain. Yet, the company was more than a roaster. It had not only combined with the coffee maker - Keurig but also strategically stretched its position on the chain. According to Kaplinsky and Morris, actors at the same position on the value chain are competitive. Upgrading strategies present opportunities to differentiate. Four types of upgrading are defined—process upgrading, product upgrading, functional upgrading and chain upgrading. A handout defining the 4 types of upgrading would be beneficial for the students. The professor might pose the following questions to the students, allowing them time to work through the handout and form thoughtful responses.

<u>Questions</u>

What upgrade strategies had GMCR instituted in the past? Describe.
What upgrade strategy seems to promise potential for the future?

GMCR employed product upgrading when it invested in fair trade certification. In more recent years, the company invested in process upgrading with supplier-oriented shared value initiatives. It seems that the future was poised for functional upgrading as GMCR moved its locus more toward retail actors on the chain with strategic alliances inside and outside of the coffee industry. The innovative movement provided the company with opportunities and strategic advantages.

2. In the *Strategic Management Journal,* David Teece wrote on the importance of "dynamic capabilities" to sustain competitive advantage. (a) Define what is meant by the concept "dynamic capabilities". Identify two "dynamic capabilities" at GMCR. (b) Describe the "microfoundations" that facilitated capability development.

2(a) Students should read the Teece article prior to class discussion. David Teece asserts that in today's sophisticated, changing environment, companies need to develop dynamic capabilities to sustain competitive advantage. Dynamic capabilities refer to "the capacity of an organization to purposefully create, extend, or modify its resource base." The theory of Dynamic Capabilities, grounded in Kirznerian, Schumpeterian and evolutionary theories of economic change, asserts that dynamic capabilities lead to organization resilience. According to Teece, "Dynamic capabilities, unlike ordinary capabilities, are idiosyncratic: unique to each company and rooted in the company's history. They're captured not just in routines, but in business models that go back decades and that are difficult to imitate" Kleiner, 2013). The willingness to explore beyond organizational boundaries was an important dynamic capability of GMCR. Students frequently acknowledge that companies must be keenly aware of new/ changing sources of advantage. Yet, awareness is not enough; exploration is the differentiator. When an organization becomes complacent, another company can rapidly capture the market. GMCR explored beyond its organizational boundaries to learn and grow as evidenced by the following:

1) Early Adoption of Fair Trade Practices and Partnership

GMCR stretched its own social consciousness and the public's when it engaged in Fair Trade practices in 1997 and signed a contract with FairTradeUSA in 2000. As the world's largest buyer of fair trade beans, the company became a leading voice for fair trade.

2) Acquisition of Keurig

When GMCR acquired Keurig in 2006, the coffee company married the brewer business. GMCR became this iconic combination of two distinct yet closely-related businesses. It emerged with keen insight on product requirements, consumer demand, and cost on both sides of the brewing process, providing for focused and thorough research and development.

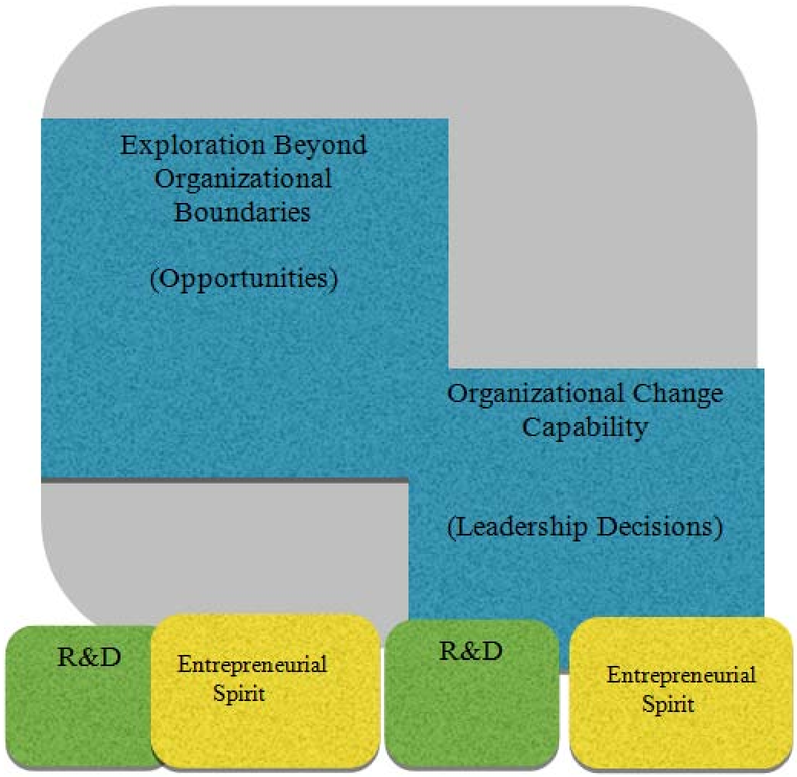
3) Innovative Alliances

GMCR formed innovative partnerships with large companies like Starbucks and Dunkin' Donuts, which gave the company broader exposure and association with select brands.

Likewise, organizational change capability represented a second dynamic capability of GMCR. Organizational change capability was defined as the ability to lead and manage change, to create, extend, and modify the resource base. According to Teece, "Dynamic capabilities reside in large measure with the enterprise's top management team" (Teece, 2007). Executive officers make key decisions that dramatically affect the nature of company and the culture. They have the opportunity to embed and enhance critical microfoundations for organizational flexibility.

2(b) Microfoundations are defined by Teece as the underpinnings of dynamic capabilities, the processes and characteristics of an organization that enable the organization to be flexible and adapt quickly. The figure below might help students visualize the relationship between microfoundations, dynamic capabilities and the organization. Entrepreneurial spirit served as an important microfoundation at GMCR. According to Teece, "Enterprises with strong dynamic capabilities are intensely entrepreneurial. They not only adapt to business ecosystems, but also shape them through innovation and collaboration with other enterprises, entities, and institutions (Teece, 2007). GMCR began as an entrepreneurial vision - to share the experience of "good" coffee. Through experimentation and discovery, Stiller created the perfect roasting process. GMCR grew out of those entrepreneurial seeds. The investment in Keurig, and the progressive step to form alliances revealed confidence and the willingness to take risk. Research and development represented a second microfoundation at GMCR. GMCR's investment in Keurig and Keurig's devotion to r&d. enabled disruptive innovation in the industry. Patents were a first round of innovation that provided a window of time to innovate further.

FIGURE 2
DIAGRAM OF RELATIONSHIP BETWEEN DYNAMIC CAPABILITIES AND MICROFOUNDATIONS AT GMCR



3. According to Teece, the role of leadership was instrumental to the **development of dynamic capabilities. Identify how GMCR executive leadership - Robert (Bob) Stiller, Lawrence (Larry)**
Blanford, and Brian Kelley facilitated organizational change capability.

It would be beneficial to begin this segment of the case with a discussion of the importance of leadership relative to strategy execution. According to senior strategy expert, Cynthia Montgomery, "The CEO is the one who chooses a company's identity, who has responsibility for declining opportunities and pursuing others" (Montgomery, 2008). The class could be divided into three groups. Each group might be assigned one GMCR executive leader to examine specifically focusing on how that leader facilitated the capability for organizational change. According to Teece, "Three types of managerial activities can make a capability dynamic: sensing (which means identifying and assessing opportunities outside your company), seizing (mobilizing your resources to capture value from those opportunities), and transforming (continuous renewal)" (Kleiner, 2003). After a period of 10 minutes, the class reconvenes as a large group, and representatives from each group share findings. As students comment on the leaders, the professor may find it beneficial to encourage key words like “sensing or “seizing’. Students will generate many of the following points and leader characterizations.

Stiller was the creator and the idea man. He sensed opportunity. He identified the potential of great-tasting coffee and invested in Keurig in 1993 when it was a mere idea. He exercised green initiatives as recycling and composting in the early years when corporations were not engaged in green practices. He established the compelling vision of conservation and the consistent mindful resource usage that supported environmental stewardship. Stiller leveraged sustainability into an advantage in the marketplace when he committed to Fair Trade in 2000. He seized the opportunity.

Blanford shared the vision, built on the capabilities Stiller established, and led transformative change. Blanford adopted a long-term, profit-centric approach through shared value. The direct involvement with the coffee bean farmer in water initiatives, food and education projects were indicative of the game-changing proposition that shared value offered. He seized opportunities to support the coffee supply chain

Kelley promoted growth through new channels and products. He sensed the importance of extension beyond coffee. With his knowledge and connections in the beverage industry, he forged (seized) partnerships outside the coffee market. Kelley reinvigorated the entrepreneurial culture in the organization and embraced growth and change.

According to Teece, “Entrepreneurial management has little to do with analyzing and optimizing. It is more about sensing and seizing- figuring out the next big opportunity and how to address it” (Kleiner, 2003). Senior management has an exceptionally significant role to foster the development of dynamic capabilities in the company to keep the advantage.

4. GMCR’s stewardship initiatives evolved from simple environmental measures to sophisticated shared value initiatives. (a) Track the progression of sustainability initiatives at GMCR. Does this progression model the adaptation and movement that dynamic capabilities enable? Why or Why not? (b) Porter and Kramer introduced the concept of “Shared Value” in *Harvard Business Review*. Define the concept of Shared Value? How was Creation of Shared Value (CSV) different from Corporate Social Responsibility (CSR)?

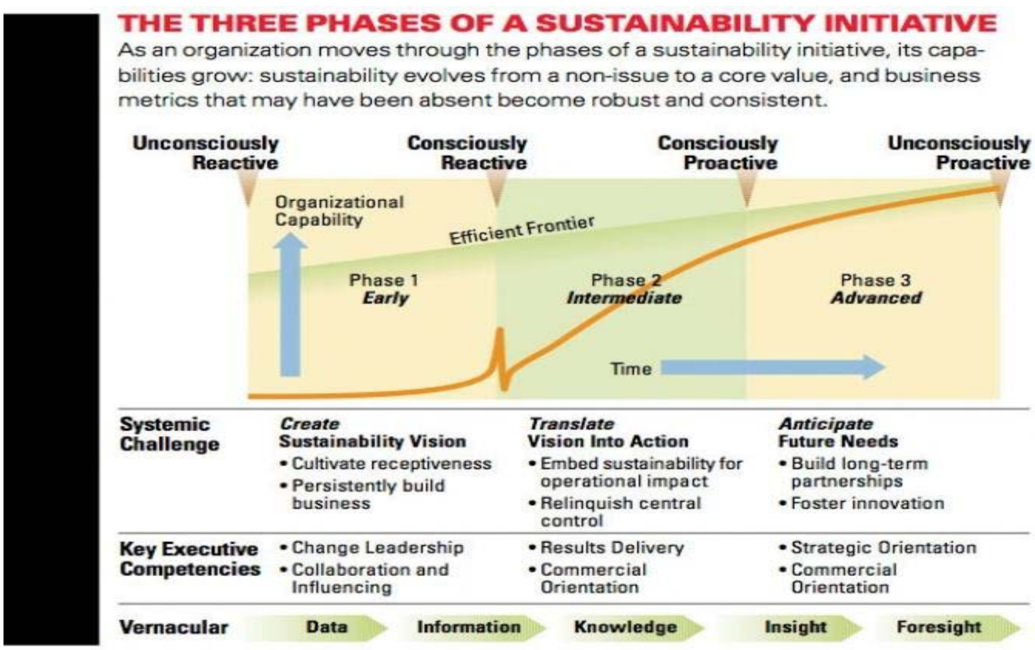
4(a) By reconfiguring its assets/competencies, GMCR met customer and supplier needs and sustained competitive advantage. Figure 3 illustrates sustainability as an evolving source of differentiation. GMCR evolved from simple environmental actions to sophisticated shared value initiatives. The increased commitment to and depth of the initiatives was indicative of the innovative, progressive movement inside the company, the entrepreneurial willingness to forge ahead. The sustainability progression serves as a model of the movement that dynamic capabilities enable GMCR’s sustainability initiatives captivated the market, evolved, secured a competitive advantage, evolved and secured a refined competitive advantage.

FIGURE 3
GMCR - EVOLVING SOURCE OF DIFFERENTIATION (SUSTAINABILITY)

Source: Treadway, 2014

Time permitting, a nice opportunity exists to tie question 3 to question 4 and connect sustainability with leadership. The diagram from an *MIT Sloan Review* article entitled "The Change Leadership Sustainability Demands" by Lueneburger and Goleman (see Figure 4) highlights the three phases of leadership for a substantial sustainability initiative. GMCR founder Stiller crossed Phase 1 and Phase 2. President and CEO Blanford started in Phase 2 and moved into Phase 3 with strategic partnerships. President and CEO Kelley assertively moved deeper into phase 3 to innovate and establish partnerships outside the coffee boundary with companies as Campbell Soup. Please note Figure 4 assumes that the organization is beginning with zero existing sustainability commitment. Yet, it is clear from the early years at GMCR, the company made a commitment to sustainability.

FIGURE 4
LEADERSHIP AND SUSTAINABILITY STAGES



Source: Lueneburger, Christopher & Goleman, Daniel (2010, Summer).
The Change Leadership Sustainability Demands. *MIT Sloan Management Review*.

4(b) The Concept of Shared Value was defined in a 2006 *Harvard Business Review* article written by Harvard Professor, Michael Porter, and Harvard Kennedy School of Government Senior Fellow, Mark Kramer. The authors elaborated on the concept in a January 2011 article follow-up. Before engaging in class discussion, assign students to read the HBR 2011 article by Porter and Kramer. The professor might place the article definition for shared value on the board. Porter and Kramer define shared value as "[the] policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates" (Porter, 2013) The theory proposes that businesses have traditionally approached societal issues as peripheral issues that only need to be addressed enough so that the consumer feels good about what the company is doing, but in actuality, if the company addresses the social needs of the market and consumers, the economic needs will be affected. This is a pertinent point to relay to students. To encourage class discussion, the professor might place the following quote by Porter on the board.

> The principle of shared value involves creating economic value in a way that also creates value for society by addressing its needs and challenges. Businesses must reconnect company success with social progress. Shared value is not social responsibility, philanthropy, or even sustainability, but a new way to achieve economic success. It is not on the margin of what companies do but at the center." (Porter, 2013)

Ask students the following question - If CSV is not CSR or philanthropy or sustainability, what is it? Then have students provide phrases from the required reading that define "shared value". Students may give phrases as "long-term", "inside profit model", "embraces social problems" or "includes supply chain management" "education initiatives" or "makes the world better" . The professor might ask class members what the phrase, "it is not at the margins but at the center" means. It is critical that students clearly understand that social and economic issues are embraced as an **integral formative part of the profitability model** and are **central to operations in CSV**. This is vastly different from CSR and represents a paradigm shift in thought. Through care and commitment to core costs for supplier welfare, companies create value, self-sustaining solutions and enduring profits. An informative quote from Porter follows.

> Not all profits are equal—an idea that has been lost in the narrow, short-term focus of financial markets and in much management thinking. Profits involving a social purpose represent a higher form of capitalism—one that will enable a society to advance more rapidly while allowing companies to grow even more. The result is a positive cycle of company and community prosperity, which leads to profits that endure." (Bizzy Resource, 2011)

The discussion will evolve into comparing CSR and CSV. The graphic below (see Figure 5) depicts key differences in CSR and CSV and could be placed on the board. The professor can talk through each difference.

FIGURE 5
COMPARISON OF CSR AND CSV

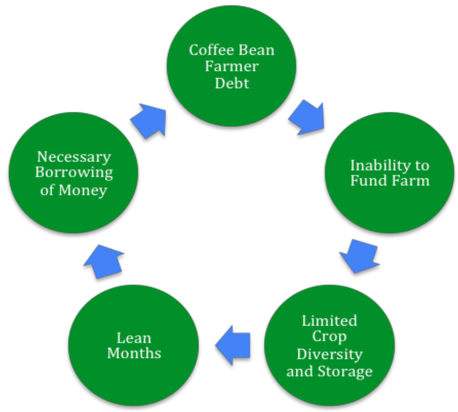
Source: http://sunidee.com/blog/a-new-way-of-doing-business-creating-shared-value.html

In traditional capitalism, businesses focus on creating value for the business. Cost-reduction practices lend themselves to short term and immediate results, and these practices eventually stop providing cost reduction and begin increasing costs. By attending to the source of the cost, the creation of shared value poses resolution for this problem. Porter and Kramer suggest that by addressing the societal issues in an appropriate way, businesses will see **enduring financial return**. The theory suggests that externalities, or societal issues, are an internal cost to the firm, and, by addressing these issues, businesses actually reduce costs (Bizzy Resource, 2013). A scenario would engage students in the material and ease explanation. The professor might distribute the following handout and read the scenario aloud, leading the class through the stages of the coffee bean farmer cycle. The professor can show the effect shared value initiatives have on the cycle by talking through the stages of the second diagram on the handout beginning with the "Ability to Fund Farm" stage. The assumption is made that the coffee farmer is able to fund the farm because of company-sponsored shared value initiatives.

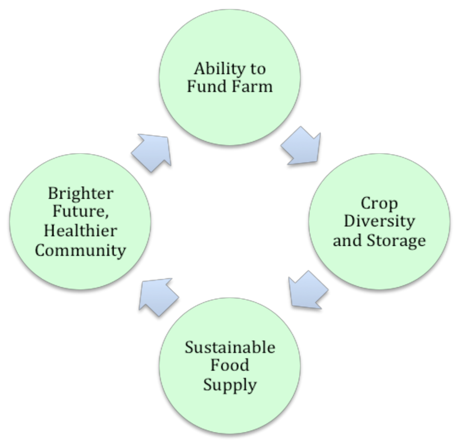
Handout on the Impact of Shared Value Initiatives

Scenario_- If the coffee bean farmer has low productivity, low income, and therefore a bleak future, the coffee company, no matter how low its transportation and procurement costs, will suffer. According to Porter's Shared Value Theory, if the company addresses economic and societal issues (coffee farmer water/food needs), both the coffee farmer and the company will benefit. The coffee farmer does not have the available resources to better his production and crops; yet, the company does. Therefore, the company should implement programs or processes to teach better farm practices, provide the farmer with fertilizer, and assist the farmer in other ways needed. Once the farmer is able to produce a better crop, the company benefits with a higher quality coffee bean, and the farmer has a brighter life and future with a better income (New Way, 2011).

Coffee Bean Farmer Cycle



Coffee Bean Farmer Cycle (with Shared Value Initiatives)



Shared Value was a central source of differentiation for GMCR. GMCR was a leader in the Shared Value movement as it turned its search for value to the actual people and communities, which made the coffee business run. In the early years, GMCR was an environmental steward and later refined that commitment to Fair Trade. (see Figure 3 IM) Since 2008, GMCR created shared value through grant programs and education initiatives. The company enabled suppliers to be more profitable in their practices and lives, which, in turn, allowed GMCR a less-costly coffee provider.

A "resilient supply chain" was a core GMCR goal as stated in the 2012 Sustainability Report(GMCR Releases , 2012), and GMCR focused on creating an environment in which its coffee growing communities would thrive and therefore be more reliable and have a brighter future. GMCR addressed supply chain issues through water resource management and food supply consistency and education. The company exemplified what Porter referred to as the Creation of Shared Value. In addressing social issues, GMCR addressed economic issues for the suppliers and the company.

Time permitting, an intriguing question to pose to the class is Do profitable companies indulge in CSV or is it the case that CSV promotes greater profitability? The answer seems to be Yes to both parts of the question. It takes money to initiate and sustain large-scale projects in supplier communities. Completion of these initiatives without ample company profit in place seems impossible. Yet, CSV enables a more efficient supply chain, less expensive and more resilient (Cost of Goods Sold decreases). The rich green company initiatives tap into consumer desire to be part of change and betterment propelling end-user demand for company products (Revenue increases). The sustainable action sustains the company.

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