

THE NESPRESSO COMPETITIVE ADVANTAGE

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Nespresso belongs to Nestlé Group and its history began in 1986. This new brand in the coffee industry was directed specially to the gourmet coffee market. The encapsulation system was not only the result of many years of development and innovation, but also its plunge into a market strongly protected by patents. From the beginning, the idea was to have a quality coffee in the office, due to the price being higher than the traditional systems used at home, and thus, it did not make sense to target at other customer segments, because Nespresso thought it would not be profitable. It focused on that segment thinking that the price would not be important in the office coffee market and that the speed in preparation and the efficient cleaning would be valued. However, they made a mistake, because the market share in office sales is very small. Turmix was requested to undertake the manufacturing process and Sobal was asked to carry out the distribution. In this way, Nespresso was the intermediary between the manufacturer and the retailer.

According to Alimarket, the final result was not the expected one. At the end of 1987, they had only sold half of the manufactured machines, but this was not enough, because they focused on a very reduced segment. Consequently, the capsules' sales was reduced and, Nespresso did not see any corporate profitability and stopped manufacturing. The competitors did not enter in the market due to the low profitability and thus, at the beginning, the encapsulation market disappeared. Nespresso was close to bankruptcy.

During the nineties, Nespresso decided to change the encapsulation market. The first change was to focus not only on the office market, but also on the home coffee market, which represented 50 percent of the coffee consumption in Spain in 2009. Furthermore, Nestlé decided to take the initiative to launch two different brands of encapsulated coffee to cover the majority of the market. On one hand, the Nespresso brand was focused on the gourmet market at office and homes and especially for people between 35 and 45 years old. Nespresso thought that the high purchasing power segment would buy expensive coffees, because they would value making personalized coffees to everyone's liking. On the other hand, the "Nescafé Dolce Gusto" brand focused on a wider type of public, which was composed by urban customers, who were attracted by new fashions and loved different cold and hot drinks, related to the "coffee moment".

According to company data, Nestlé was running the "Co-branding" strategy that consists in offering a product mix which at the time focused on huge varieties that have the following trilogy of benefits: quality, comfort and pleasure. Furthermore, Nespresso does not manufacture the machines, it is now allied with Krups and De'Longhi, which add technology and design development, such as in the old business model.

The product range is divided into two brands. Nescafé Dolce Gusto offers the varieties of espresso, decaffeinated espresso, latte machiato, cappuccino and chocolate, as well as, cold beverage capsules to cover "the cold and hot beverage mixed with milk" market and so reach as many consumers as possible. Nespresso focuses on quality coffee, in particular, in offering the opportunity to more costumers to enjoy "the perfect coffee experience". The product range is wider, divided into small coffee cups such as Ristretto, Arpeggio, Roma, Decaffeinato intenso, Livanto, Capriccio, Valluto, Così and Descafeinato and the intense and creamy range for big cups such as Vivalto, Descafeinato, Lungo and

Finezzo. Although both brands offer a quality coffee, Nespresso is a perfect coffee, and that is reflected in the price. In September 2013 each Ristretto Dolce Gusto capsule cost 0,28 cents, versus the 0,33 cents of Nespresso capsules.

Both the distribution carried out as well as the marketing are the main success factors of this business model. The key management elements are the marketing campaign, the original coffee distribution and the conversion of clients into members of the Nespresso Club. The marketing campaign has launched the brand to the highest, thanks to the intense campaign on television, newspapers, and internet, which were based on the slogan "your coffee shop at home". The brand's ambassador, George Clooney since 2004, has totally changed the image with his sentence "What else?". Moreover, Nespresso has been an innovator in marketing in the English language in Spain. The campaign has been aimed at the segment identified as potential customers. For this reason it has been much more effective than the general campaigns which have traditionally worked with other well-known brands.

The distribution has been carried out intensively by the brand. This makes a difference with the old business model, where a third party distributed capsules to the final consumer and despite the fact that the coffee had been sold in its majority to supermarkets and hypermarkets. Nestlé decided to innovate in this sense, through an exclusive product sale in specific boutiques, internet and by telephone. Though at the beginning it seemed very risky, it turned out to be a success. According to Alimarket, in 2010, 50% of the capsules were sold online, 30% at boutiques and 20% by telephone.

In Spain, everyone that wants to buy Nespresso capsules has to log in the website and the customers pass from being customers to become partners, having access to 24 hours/7 days service. They can enjoy the product at home in a maximum of 2 days. Thanks to that, it offers a personal attention to all the partners who have doubts about how the machine works and the different types of capsules. Moreover, this personal attention avoids the profit margin of the distributor and offers a direct service without intermediaries, obtaining, in this way, first-hand knowledge about customer consumption.

When Nespresso appeared, the change in the Spanish coffee industry was notorious. Before the appearance of this new encapsulation system, two main types of coffee were available. First the roasted coffee beans or the ground roasted coffee. Second the soluble coffee also known as instant coffee. One important difference between them is their quality. The roasted coffee keeps its original aroma and it can also be conserved during more time. The soluble coffee has, as its main advantage, a fast elaboration. Capsules have the benefits of both types, which is a main reason for its success.

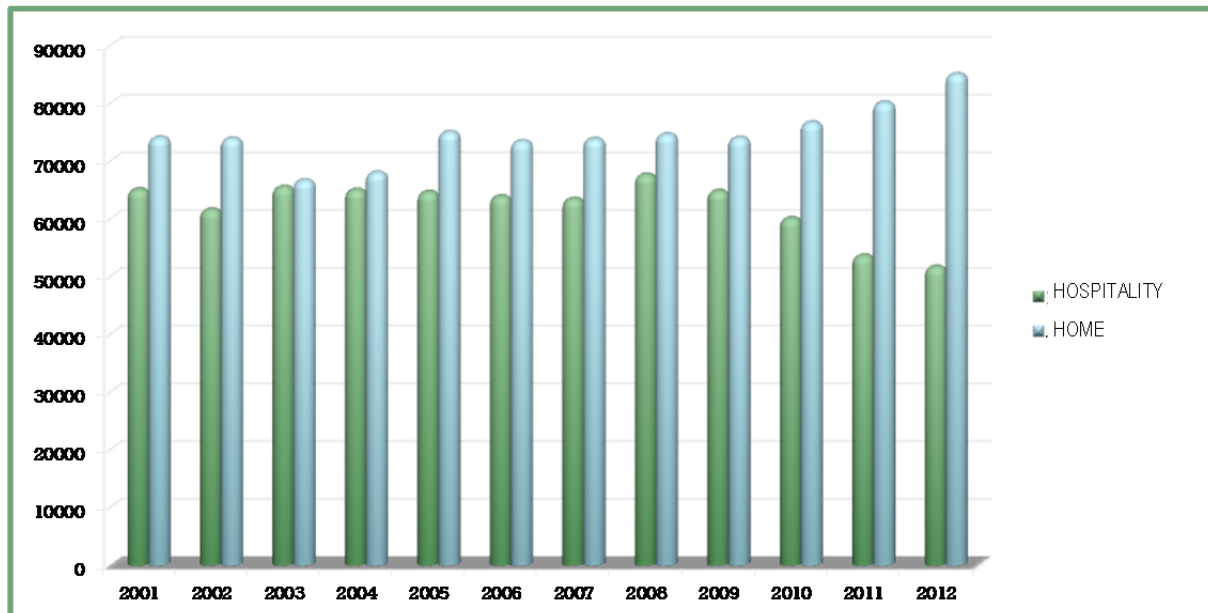
One clear sign of the success obtained has been the increase of its market share. In 2005 Nestlé was situated with the Nescafé brand in the third position of the market share, exceeded by the white label and its direct competitor, Marcilla. The competitors took years to launch into the encapsulation market. Thanks to that reason, Nespresso has positioned itself as the only offer in this encapsulation segment.

In a country like Spain, with one of the highest coffee consumption outside home, due to our "bar tradition", the Hospitality segment has descended for the first time in its history by 10% in three years, between 2009 and 2012. This was previously unthinkable and Nespresso has achieved it with the "a coffee shop at home" message.

It could be said that the coffee consumption descent in cafeterias in 2011 is due to two variables: crisis and capsules. Economic downturn has reduced the coffee consumption, while capsules

have been promoting the home canal against the cafeteria consumption, which has been losing market share for 5 years; in total, a 9.1% market share. In 2012, the market share was 62.88% for home consumption and 37.12% for cafeteria consumption. Thus, it might be said that capsules have won the battle, not only against the Spanish cafeteria, but against coffee shops like Starbucks.

Figure 1. Consumption evolution in Spain between 2001 and 2012 (in tons per year)



Source: Spanish Coffee Federation (2012)

The variation in the coffee cup price has also greatly increased. The International Coffee Organization had already analyzed that during 2009 it was increasing by 2%, switching to a small descent of -1.2% in 2010, and then an increase of 7.6% in 2011, largely due to the encapsulation market. The Nespresso coffee has a price equivalent to 70 euros per kilo of coffee. Nespresso has multiplied the coffee price by 10, due to the fact that in 2007 the coffee price in Spain was between 6 and 9 euros.

In the end, data speak. Nestlé has obtained a competitive advantage achieving a great growth, in the midst of the recession, between 2009 and 2012. This success is not only due to technology and patents, because they have had them for more than 20 years. Despite the fact of the first failure, Nespresso has created a competitive advantage that mixes product, marketing, segmentation, manufacturing and distribution, making it impossible or very difficult to copy.

According to the Nespresso data, the reputation of the brand in our country has increased by 400% between 2010 and 2011, standing over 90% in brand ranking. Spain is the first country in number of shops and third in turnover volume after Switzerland and France. In the end, it has positioned the brand at the top and has created a secure competitive advantage which is going to last years. It only depends on them to keep it. Nonetheless, the Nespresso success has attracted other competitors to manufacture the encapsulation coffee, to take advantage of the market success. Some competitors manufacture compatible Nespresso capsules but with a low price (such as L'Arôme de Marcilla or the DIA white label) or have designed their own capsule systems (Senseo of Marcilla, developed with the Philips machines).

Question: Which is the Nespresso competitive advantage and how is that advantage identified? Which are the sources or reasons of that advantage and which will be their risks in the future?

Additional information sources

- Alimarket Online. Información Económica Sectorial: www.alimarket.es
- Federación Española De Café (FEC), Spanish Coffee Federation: www.federacioncafe.com
- Nespresso: www.nespresso.com