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Criteria	Achievement level					
	Examiner 1	maximum	Examiner 2	maximum	Examiner 3	
A research question	2	2		2		
B introduction	2	2		2		
C investigation	3	4		4		
D knowledge and understanding	4	4		4		
E reasoned argument	4	4		4		
F analysis and evaluation	3	4		4		
G use of subject language	4	4		4		
H conclusion	1	2		2		
I formal presentation	3	4		4		
J abstract	2	2		2		
K holistic judgment	3	4		4		
Total out of 36	31					

EXTENDED ESSAY

Business and Management

Research Question:

Given its success factors, should Nespresso implement strategic changes in order to tackle the increasing competition?

Candidate Name:

IB Candidate Number:

School Name:

School Number:

Adviser:

Date Submitted: *February 22, 2013*

Word Count: 3924

Abstract

The finality of this research project is to approach Nespresso's actual situation and reach a conclusion of whether the Swiss corporation should change its operational and marketing strategies to maintain its leading position in the capsule coffee market.

Throughout the essay this paper will aim to answer the question **“Given its success factors, should Nespresso implement strategic changes in order to tackle the increasing competition?”**

With the use of analytical tools such as SWOT analysis, Life Cycle charts and the Ansoff's Matrix, this project aims to gain a deeper insight into Nespresso's company profile and its success factors to evaluate its performance within the sector as well as the company's possible future strategic moves.

Through the study of the market and the evaluation of Nespresso's market share and revenue, gathered through secondary research, this investigation reveals the effectiveness of the brand's pricing and distribution strategies which are based on the multi-channel but direct distribution to the end consumer, a trait that allows the corporation to gain considerably high margins of almost 80% in comparison with the other brands in the sector, which generate much lower margins of about 40%.

Motivated by the expiring of Nespresso's patents in 2012, and due to the reluctance of the court to protect the Swiss giant, Nespresso has to face the imminent emergence of fierce competition within the sector. This investigation thoroughly evaluates possible strategic changes that Nespresso could effectuate in order to tackle the competition, which seeks to gain a higher market share by means of aggressive marketing and pricing strategies.

After evaluating the researched information, this extended essay concludes that Nespresso should maintain its direct distribution to the end consumer, enhance its premium pricing and focus on important changes of product features to maintain its undeniable leadership within the capsule coffee market.

WordCount: 300

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Introduction

Nestlé Nespresso S.A. is a Swiss company which developed the capsule coffee concept back in the 70s, and today leads the sector being recognized as one of the most successful brands of all times.

Throughout this research project I am going to analyze Nespresso's key factors to success as well as its actual situation within the capsule coffee market and the possible strategic decisions the brand should make in order to overcome the recently emerged competitive environment. The main goal of this essay is to evaluate the company's profile and future options as well as the actual situation of the coffee market, searching for a response to the following question:

Given its success factors, should Nespresso implement strategic changes in order to tackle the increasing competition?

Concentrating on the production methods, innovation and strategic analysis, this paper will respond to the research question from the perspective of the marketing management and business strategy fields.

This research question is highly interesting and valuable from a business point of view because it deals with very important traits in terms of strategic managing and the findings can be useful for companies in other sectors which are submerged in similar situations. Analyzing the evolution of a giant like Nespresso can provide a deeper insight into highly successful strategic managing in a very competitive market.

This investigation will use researched data and analytical tools such as SWOT analysis, Ansoff's Matrix or Product Life Cycle graphs to approach the research question in a detailed manner and decide whether the Swiss brand should effectuate strategic changes in order to confront the increasing competition.

Key Factors to Success

With more than 10 million loyal customers, 270 boutiques all over the world and a turnover of over CHF 3 billion¹, Nespresso has become the absolute leader in the coffee capsule market.

Few people know that behind such undisputed success lies an extremely tumbling beginning, with continued failures and huge losses that prolonged over a period of 20 long and obscure years.

Rejected over and over again by the HoReCa (Hotel, Restaurant, Catering) industry and the office market (at work coffee concept), it was not until the early 90s that Nespresso began to become the giant it is today.

Year 1974, Switzerland. Eric Favre, a young Swiss engineer, came up with a small mono-dose coffee capsule and developed a special adapted coffee machine. Little did he know of the potential of his idea when, that same year, Nestlé acquired the capsule concept.

Already having reached a leading role in the instant soluble coffee sector with Nescafé, the Swiss brand wanted to expand its borders towards an area in which they were only number four: The R&G (Roast and Ground) coffee sector.²

As a result Nestlé decided to effectuate a spin-off and invest in this revolutionary concept. In 1986, a new subsidiary company was born with the name of Nestlé NESPRESSO SA.

With this new business still economically troubled, Nestlé decides to carry out the external recruitment of a new entrepreneurial manager, in hopes of hitting the right button and finding the key to success in order to start an uphill evolution.

And so it was. Executing a strategic shift away from the office and gastronomic market, they started to develop a new project in which the targeted sector was the household market. This innovative change of perspective triggered the growth of the brand.

¹ Nestlé. (2012). *2011 Annual Report*. Vevey, Switzerland: Nestlé, p. 37

² Adrian Slywotzky: *Demand: Creating what people love before they know they want it* (London: Headline, 2011), 164.

From my point of view, three main strategic decisions made up the new and effective pillars of Nespresso's unstoppable growth and contributed to its posterior success:

1. **Avoiding intermediate distribution** channels such as supermarkets and instead pursuing a direct approach to end consumers. This allowed the brand to **increase its margins** noticeably.
2. **Licensing the coffee machine patents** to partner businesses (De'Longhi or Krups, for example) through strategic alliances and therefore **steering free from the hassle of machine production** and distribution, concentrating all the resources and investment on the development of the aluminum coffee capsules and the marketing of the brand.
3. Creating an **exclusive consumer community** called 'Nespresso Club' which enables the members to enjoy multiple service advantages and benefits and therefore obtaining an important increase in **customer loyalty**.

Viewed from Nestlé's point of view, we can talk about two main steps in the strategic decisions that catapulted Nespresso to the success it has now.

First, Nestlé decided to develop a new product and brand for a new market they pioneered, the capsule market. Therefore, their first strategic decision was to develop a diversification.

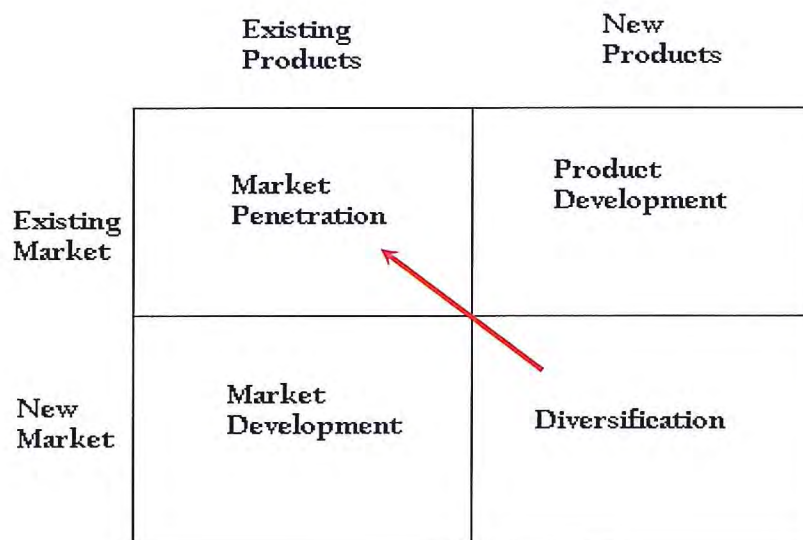


Figure 1: Ansoff's Matrix of Nestlé's strategic evolution of Nespresso

Secondly, after understanding the potential of the idea, the formerly newborn brand (Nespresso), headed for a strong market penetration using the marketing mix in order to push the product, gaining the large market share it has today in a relatively short period of time.

From that point onwards, the Swiss subsidiary started its global expansion, achieving huge profits and becoming one of the most successful brands of all times as well as a leading business in the coffee sector.

Nespresso turned into a goldmine in the intensely battled coffee market. It has become one of the few brands that act as a beacon in the sea of faceless products.³ Now, after 27 years of employee training and expertise polishing, they have developed a business model which is hard to copy due to its distinctive marketing approach and innovation.⁴

Nespresso's R&D team has been developing the capsule concept for years: A coffee machine of small dimensions which is capable of pressing hot water through the coffee filled aluminum capsule with 19 bars of pressure, allowing everyone to make the perfect cup of espresso in their homes and within a few seconds. The magnitude and potential of the Nespresso concept has been globally recognized as one of the most innovative ideas within the past decades, but at the end, it is only coffee, right?

Wrong, or at least that is what the Nespresso managers have set as one of their primary goals. A search for a whole new level, a 'Much more than coffee' business perspective which has catapulted the Swiss brand up high and into a comfortable situation on the top end of the sector, where the huge profits are.

With stores in 50 different countries and more than 7000 employees all over the world, Nespresso has become the star subsidiary of mother company Nestlé, with a turnover contribution of approximately 4.2% (estimation, since Nespresso, being a subsidiary, does not publish financial statements) Nestlé's total sales and a much higher percentage of Nestlé's Operating profit.⁵ How is this huge profitability possible? Below follows an analysis of Nespresso's key factors to success.

³ Hermann Wala, *Meine Marke* (Munich: Redline, 2011), 13.

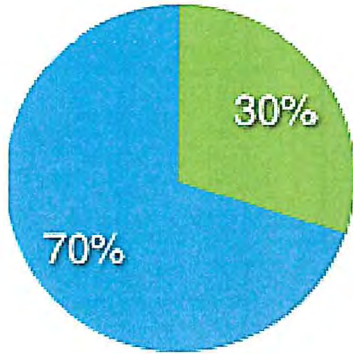
⁴ David Taylor, *Grow the core* (Chichester, UK: John Wiley & Sons Ltd, 2013), 65.

⁵ Refer to Appendix I - Nestlé. Consolidated income statement for the year ended 31 December 2011.

Nespresso's huge Market Share

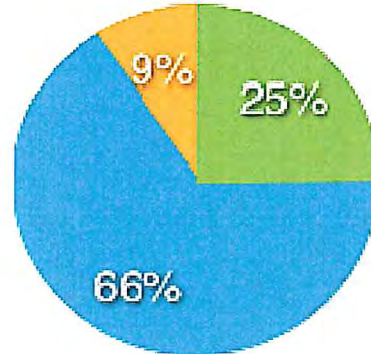
Nespresso pioneered the Capsule Coffee sector, which today represents approximately 9% of the entire global market, as it is shown in Graph 2:

- Instant Coffee Sector.
- R&G Coffee Sector.



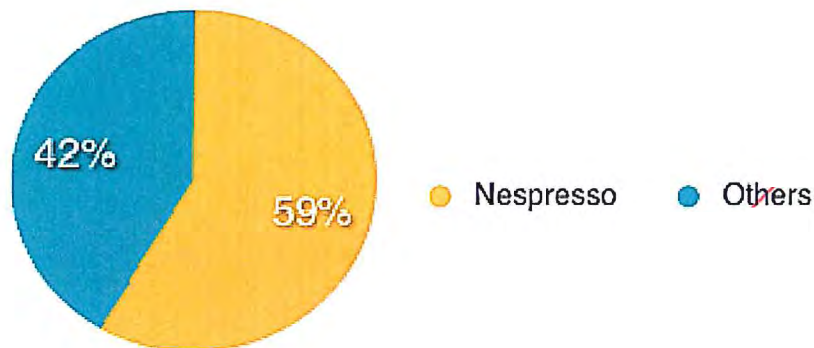
Graph 1: World Coffee Market in 1975.

- Instant Coffe Sector.
- R&G Coffee Sector.
- Capsule Coffee Sector.



Graph 2: World Coffee Market in 2012.

One of the biggest strengths that Nespresso has is its relatively large control of the sector with a very high market share. As shown in Graph 3, Nespresso almost reaches 60% of the high margin single-serve coffee sector.⁶



Graph 3: Market Share in the Capsule Coffee

⁶ Nestlé Nespresso SA. (2012). *Corporate Backgrounder*, Vevey, Switzerland: Nestlé Nespresso SA.

Expensive Capsules, Affordable Machines

Nespresso capsules are expensive, everybody knows that. But how expensive exactly? Below we have the price comparison between the Nespresso coffee and other important brands in the sector.

Nespresso capsules are available in boxes containing 10 units. In order to study the price tendencies, we will carry out the analysis in terms of price per capsule and price per kilogram.

Table 1: Nespresso Capsules: Price per unit.

Nespresso Capsule Type	Coffee amount	Price per Capsule
Espresso Capsule	5g	0.36€
Lungo Capsule	6g	0.39€
Pure Origin	5g	0.40€
Hawaii Kona (Special edition)	5g	1.20€

Table 2: Price comparison per kilogram.

Bonka	Lavazza	Hawaii Kona (Feuerberg)	Nespresso
8€/kg	21€/kg	54€/kg	72€/kg (5g Espresso) 65€/kg (6g Lungo) 80€/kg (Pure Origin) 92€/kg (Ristretto India) 240€/kg (Hawaii Kona limited edition)

We can observe a huge price difference of more than 60€ between the cheapest Nespresso coffee in the 5g espresso capsules, and the average Bonka Arabica coffee which is sold by Nestlé as one of its R&G (roast and ground) coffee brands, being Bonka Arabica probably of a similar quality as the one we can find in the capsules.

We just looked at regular or average coffee, but even if we refer to one of the best Italian coffees available in the market, considered to be a premium coffee, the difference is still overwhelming. We can obtain the Lavazza premium coffee for 21€/kg, whereas customers would have to pay 51€ more for a kilogram of Nespresso's Lungo, a quantity which ascends to more than 180€ if we compare Nespresso's limited edition (Hawaii Kona) with the Hawaii Kona from Feuerberg, a German premium roaster.

After analyzing this price difference, we ask ourselves a question: How is it possible that customers pay a much larger amount of money for the average quality Nespresso capsules? The answer lies in the so called capsule phenomenon.

Taking advantage of this phenomenon, Nespresso is able to push the coffee prices up to new and extreme levels, without losing any demand and therefore maintaining its market share. This trait, apart from generating huge benefits, sets the Swiss brand far away from its competitors, and making it almost immune to one of the biggest concerns of other coffee brands: The ups and downs of the coffee prices as a commodity.

Whereas companies selling coffee at more affordable prices are extremely affected by shifts in the commodities, Nespresso takes advantages of their huge margins and sets itself in a very safe position, where the effects of these shifts are minimized due to the huge difference in prices between raw coffee and Nespresso's finished product.

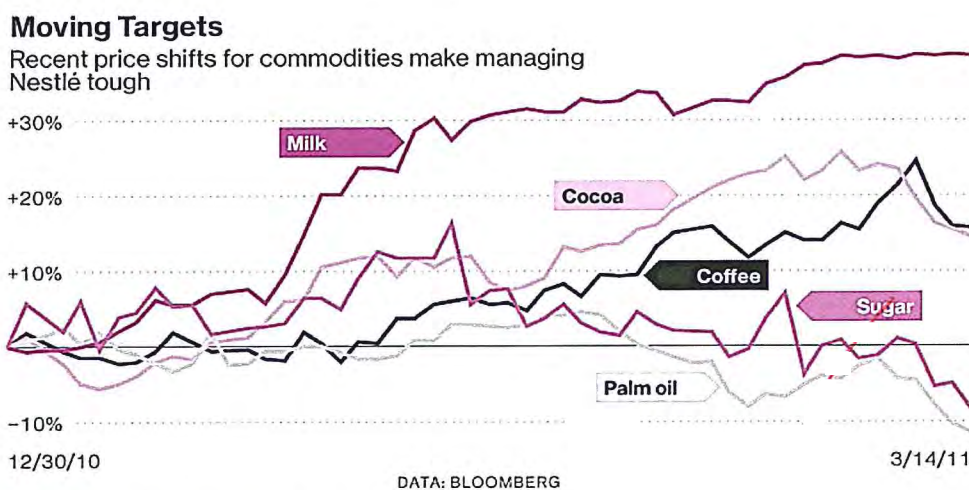


Figure 1: Shifts in commodity prices for the year 2010⁷

⁷ Tom Mulier. 'Nestlé's Recipe for Juggling Volatile Commodity Costs.' *Bloomberg BusinessWeek* (March 16, 2011), <http://www.businessweek.com/stories/2011-03-16/nestl-s-recipe-for-juggling-volatile-commodity-costs> (accessed February 12, 2013).

The capsule phenomenon we have been talking about is based on the 'affordable machines, expensive capsules' strategy.

Table 3: Strategic affordable price of coffee machines.

<p style="text-align: center;">De'Longhi Nespresso Essenza</p>	<p style="text-align: center;">59,95€ (Market Price)</p> <p style="text-align: center;">99€ (Official Price)</p>
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As seen in table 3, the Nespresso machines are very affordable in comparison with other brands. Why are the capsules so expensive but the machines so affordable? Shouldn't it be the other way around? In every business we can find the so called entrance barrier which was once defined by Porter. In luxury cars, for example, the entrance barrier is so high that only a small sector of the population is economically able to afford the company's products. With this strategy, on the other hand, the entrance barrier into the Nespresso world purchasing a Nespresso machine can be extremely low and therefore accessible to almost anyone. As we can see from the tables 2 and 3, buying a new machine, in this case the Essenza, can cost less than one kilogram of the coffee you will be then consuming. That is Nespresso's secret.

By setting these low prices on the machines, a very large sector of the population is able to skip that entrance barrier and join the Nespresso experience, but signing up to a continuous spending on capsules converting the Nespresso market an everyday more inelastic market. This low entrance barrier but high capsule dependence creates a stability in the market. This capsule dependence cycle in which the consumer gets involved, is comparable to the biologic experiment in which a frog is placed in boiling water, jumping out immediately due to the shock factor. On the other hand, when placed in water with a gradual increase in temperature, the frog doesn't notice the heat until it's too late. By eliminating the initial shock factor of a very expensive machine, Nespresso is able to guarantee itself a continuous income based on its expensive capsules from a very broad base of customers.

The machine retailers are promoting and explaining the Nespresso experience, with a relatively small margin on the machines. Consumers are easily convinced to join the Nespresso

concept often not realizing that they just entered a largely overpriced consumer habit which turns them into the so called captive customer, creating a stabilizing shift in the demand curve.

The path to this success was lead by the strategy of Nespresso encouraging retailers to provide customer trials so these could experience both machine and coffee. This approach generated an increase in sales since six times more machines were sold at stores with coffee tastings⁸, and therefore, six times more future potential capsule consumers were attracted.

The Elite Experience

Another key factor of Nespresso's success is based on its CRM (Customer Relationship Management) excellence.

Avoiding intermediate distribution channels such as supermarkets and instead pursuing a direct approach to end consumers, allows the brand not only to increase its margins noticeably (almost 85% in comparison with the 40% of regular drip-coffee brands⁹), but also to differentiate themselves from so called 'everyday groceries' or basic food supply. Nespresso achieved to take its capsules out of the supermarket shopping list and this is a vital factor.

The customers buy milk, bread, meat and other basic food in the supermarket, and then, three streets away, walk into the Nespresso boutique to buy some Volluto capsules with Mr. Clooney. It is this factor that elevates the capsules to a 'much more than grocery' state among the consumers. It has been converted into the so called gourmet coffee.

The Nespresso experience has achieved a similar social phenomenon than the one carried out by Apple in the electronics sector. The experience of entering the elegant boutique, filled up with a blend of exotic coffee aromas, makes the customer feel part of an elite.

This apparently luxurious ambience was even more accentuated with the creation of an exclusive consumer community called 'Nespresso Club', enabling the members to enjoy multiple service advantages.

⁸ Adrian j. Slywotzky, *Demand: Creating what people love before they know they want it* (London, UK: Headline, 2011), 177.

⁹ Joshua Levine. 'Pod of Gold.' *Time Magazine* (March 07, 2011), <http://www.time.com/time/magazine/article/0,9171,2053573,00.html> (accessed February 16, 2013).

Nespresso's distribution policy within a multichanneled but direct approach, complemented by a business to business strategy aiming at the premium segment (Nespresso is served in the First Class of airlines like Swiss or British Airways and in luxury hotels), along with the delivery service and e-commerce have been a key trait in Nespresso's success.

Patents expiring, competition multiplying

Past 2012 year was a crucial one for Nespresso. Many of its patents expired after 25 years and courts in Switzerland and Germany rejected Nespresso's lawsuits against manufacturers of capsules which are marketed as compatible with Nespresso machines.

This factor has a great impact on the Swiss brand, because it means losing the exclusivity in a market in which they were offering a Unique Selling proposition and therefore occupying the market shares.

The latest setback was in February 2013, when a German appeal court decided against Nespresso's arguments and allowed the Ethical Coffee Company to sell their compatible capsules.¹⁰

Even in its home country, Switzerland, Nespresso is starting to feel the pressure of competitors which are trying to implement a market penetration, setting prices just under the Nespresso capsules.

Luckily for the Swiss brand, the price difference, as we can see in table 4, is still not enough to take away market share from Nespresso, but they are getting dangerously close. Especially after many initiatives from local public TVs like SRF, that set Nespresso down to the second position in a blind-test carried out among volunteers from the general public.

¹⁰ Ben Bouckley. 'Nestlé loses skirmish in Nespresso coffee capsule wars' *Beverage Daily* (Feb. 22, 2013), <http://www.beveragedaily.com/Manufacturers/Nestle-loses-latest-skirmish-in-Nespresso-coffee-capsule-wars> (accessed Feb 22, 2013).

Table 4: Price and taste ranking (Blind tests effectuated by Swiss TV SRF) comparison between Nespresso and competitors in Switzerland.

Capsule Brand	Price per Capsule	Position in blind-test
Nespresso	0.50 CHF	2
Café Vergnano	0.39 CHF	4
Migros	0.38 CHF	1
Denner	0.33 CHF	3

After losing part of its patents, Nespresso is starting to feel the urge of changing some of its policies or strategies in order to escape from the growing compatible or even refillable capsule competitor range coming from many different countries. Nespresso leaders are conscious of the threat, and are starting to evaluate the situation.¹¹

Table 5: Price comparison between Nespresso and competitors in Spain.

Capsule Brand	Price per Capsule
Nespresso	0,39 €
Torrié	0,389 €
Sara Lee (Marcilla)	0,36 €
Ethical Coffee Company	0,319 €
Caffè Vergnano	0,305 €
Café Fortaleza	0,305 €
Oquendo	0,28 €

¹¹ John Revil. 'Nespresso Reshuffles as Rivals Wade in' *Wall Street Journal* (November 21, 2012), <http://online.wsj.com/article/SB10001424127887324352004578132943986605034.html> (accessed February 10, 2013).

Nespresso is not only worried by the increasing compatible capsule market , but also with the growing number of brands which are developing own similar systems to enter the capsule market ¹² (see table 6).

After only one year of losing the patents, competitors in this area are still struggling and selling a very small volume because they are trying to set very high prices (even higher than Nespresso, in some cases) in order to make a high margin and occupy part of Nespresso’s market share. But this fact does not make this potential threat less dangerous.

Table 6: Competitors entering the capsule coffee market with own systems.

Brand	Price per Capsule
Illy (Iperespresso)	0.45€
Starbucks (Verismo)	0.42€
Fagor/Cafento (Stracto)	0.39€
Kraft (Tassimo)	0.30€
Digrato	0.25€

“We don’t mind competition -we counted 31 competitors at the end of last year - but when someone comes into your home and uses your bathtub, you are certainly going to say, ‘Hold on! That’s my bathtub’ ” says Richard Girardot, Nespresso’s CEO. ¹³

The Eco-Wars

One of Nespresso’s greatest concerns is the large number of critiques they are lately receiving coming from ecological organizations. These organizations are trying to warn about the polluting harm that the aluminum capsules can cause to the environment.

¹² Nestlé. (2012). *2011 Annual Report*. Vevey, Switzerland: Nestlé.

¹³ Joshua Levine. ‘Pod of Gold.’ *Time Magazine* (March 07, 2011), <http://www.time.com/time/magazine/article/0,9171,2053573,00.html> (accessed February 16, 2013).

Such is Nespresso’s concern that they started to promote greener solutions and develop new CSR policies in order to dissipate the critics and adopt a more sustainable quality development approach, like sourcing the majority of its coffee through the Sustainable Quality program awarded by the Rainforest Alliance or encouraging customers to bring the used capsules to the nearest boutique in order to be recycled.

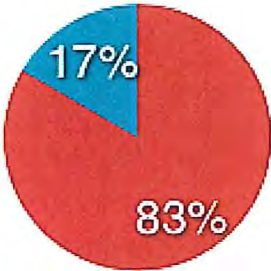
Competitors are taking advantage of this weakness of Nespresso to try and win the capsule battle on the green side. Looking back at Table 5, one of the strongest competitors which is giving Nespresso managers real headaches in this Eco-War, is the Ethical Coffee Company. The ECC, managed by Jean-Paul Gaillard, is using his past experience and knowledge as Nespresso CEO to develop a truly competitive coffee capsule. A bio-degradable capsule made of plant fibers and starch, which disintegrates in the waste process after a period of about six months.

Who will obtain victory in the Eco-Wars? Nobody knows it yet, but if something is absolutely clear it is that both brands are immersed in a fierce fight for market share and profits:

“Nespresso does not hesitate in lying to you and will go as so far to pay bloggers to discourage you from buying our capsules”¹⁴

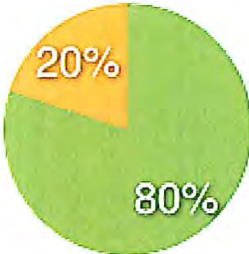
In the middle of this frenetic competition battle full of polemic declarations, court battles and coffee capsules, Nespresso has to evaluate every possibility it has towards the future. They have to act in order not to lose the market share they have enjoyed until now within the gourmet coffee sector:

- Commercial Grades
- Gourmet Coffee



Graph 3: Actual Coffee Market distribution.

- Other
- Nespresso



Graph 4: Actual Gourmet Coffee distribution (including all types of gourmet coffee available)

¹⁴ Ethical Coffee Company. (2013) *Ethical Coffee Company Official Web Page*. Fribourg, Switzerland: Ethical Coffee Company, <http://www.ethicalcoffeecompany.com/en> (accessed February 18, 2013).

Taking into account the emerging competition, Nestlé knows that its subsidiary is in danger of entering a stage of decline in the life cycle, affecting the quantity and quality of the marketing support that will be required, as well as losing market share and high margins. Using my research data to draw a life cycle table, I created the following figure to explain the situation:

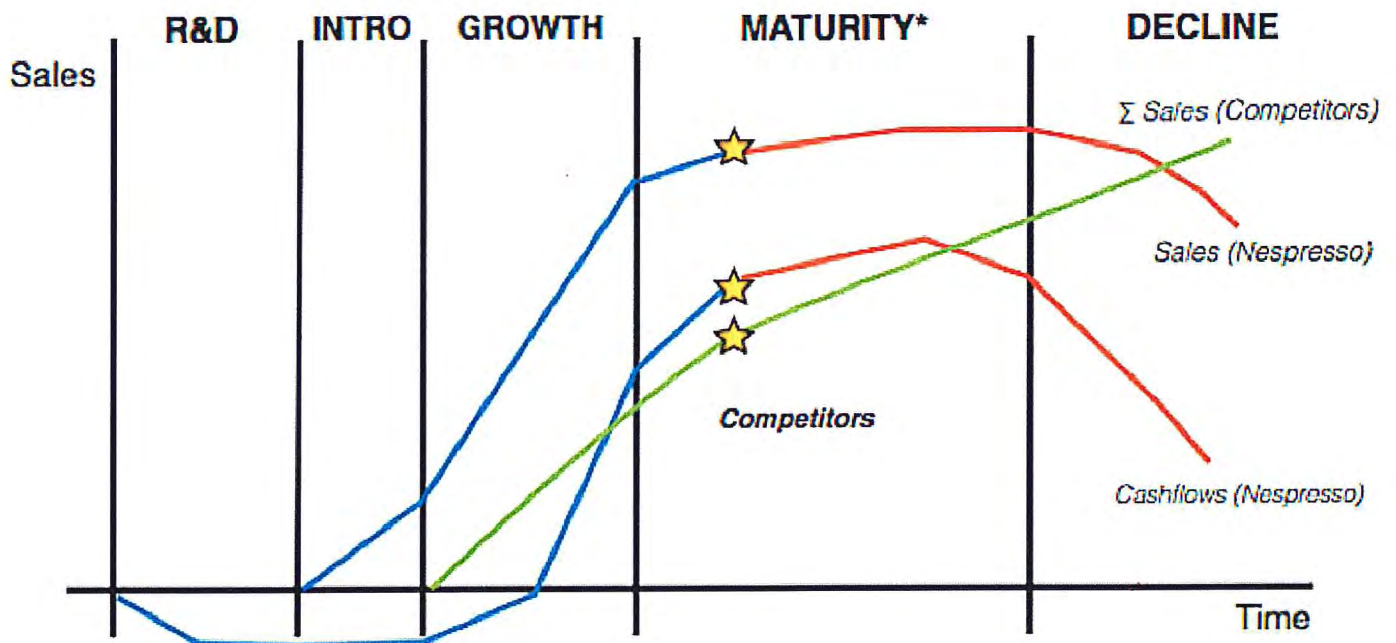


Figure 2: Predictive Product Lifecycle for Nespresso if competitors win the capsule battle.

<p>Actual Situation (★ 2013)</p> <p>Possible Future (Threats)</p> <p>Σ Competitors</p> <p>(*) Nespresso's Actual State</p>
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In order to analyse Nespresso's actual situation, a SWOT analysis will be used. This analysis allows to gain a deeper insight in Nespresso's strengths, weaknesses, opportunities and threats in order to decide whether the company should make strategic changes of the distribution system, the pricing and maybe even the material the products are made of.

Figure 2: SWOT analysis for the Nespresso Company

Strengths	Weaknesses
<p><i>Brand Image.</i></p> <p><i>Knowledge about customers (CRM).</i></p> <p><i>Large Market Share.</i></p> <p><i>Experience built up over years.</i></p> <p><i>Strong knowledge in coffee sourcing.</i></p> <p><i>Strong financial support from Nestlé.</i></p> <p><i>Excellence in e-commerce.</i></p> <p><i>Almost immune to commodity shifts.</i></p>	<p><i>Limited availability of capsules in certain geographic areas.</i></p> <p><i>Customer doubt about the Corporate Social Responsibility of Nestlé and Nespresso.</i></p> <p><i>Usage of aluminum in capsule production which is environmentally harmful.</i></p> <p><i>Overpricing of the product.</i></p>
Opportunities	Threats
<p><i>Interest in coffee is increasing worldwide</i></p> <p><i>Shift from `drip coffee` to espresso in large markets like the USA</i></p> <p><i>Past negative experiences with compatible competitor capsules in Nespresso machines</i></p> <p><i>Demand from clients for the Nespresso concept is rising gradually in the hotel and restaurant businesses</i></p>	<p><i>Patents expired and judges are reluctant to protect the giant from its emerging competitors</i></p> <p><i>Motivated by the difficult economic situation in some countries, customers look for cheaper coffee solutions</i></p> <p><i>Strong retailers want to have their fair share of the capsule market and push compatible capsules or alternative systems</i></p> <p><i>Environmental concerns are rising all around the world, making some customer choose greener solutions</i></p>

Nespresso's next step?

After analyzing Nespresso's key success factors, its actual situation and the competitive threats it is currently experiencing, I will proceed to evaluate its possible future movements in order to leave the competition behind.

THE PRODUCT

The premium strategy should be continued. The use of limited editions to differentiate the product even more from that of the followers should be intensified.

An interesting product innovation would be the substitution of the aluminum material by a less environmentally critical one. This would require a new R&D approach, in which neither the esthetics nor the functioning of the capsules has to be compromised.

THE PRICE

As mentioned before, the premium strategy is the only way to maintain the brand image and the high margins.

Limited offers of extremely highly priced and interesting product variations (like the Hawaii Kona), should be part of the new pricing strategy. The main goal is not the volume of sales but the visibility in the media, adding even more profile to the brand image.

THE PLACE

The core decision affects distribution. Most competitors try to attack Nespresso there where they think lays its weakness: Availability.

For example, the Ethical Coffee Company has built up an intense distribution network. In France, you can find the capsules almost everywhere; retailers like Auchan, Carrefour, Simply Market, Casino, Monoprix or Leader Price (some of them even selling the ECC capsules under their own retail brand) offer them at literally thousands of points of purchase.

Sara Lee with its coffee brand Marcilla, likewise sells its capsules in the most important retailers in Spain like El Corte Inglés, Mercadona, Carrefour, Hipercor, Alcampo, Eroski and alikes.

The paradox of this situation is that the competitors are obliged to charge almost as much per capsule as Nespresso, due to the margin requirements of retailers. So the end consumer does not perceive a significant saving. The strongest competitor, Sara Lee, who's Marcilla capsule is seen by customers as a mere copy of the Nespresso capsule, does not offer a price difference worth mentioning.

This situation puts the followers in a difficult position because due to the low margins, they do not have enough budget to compete with the excellent marketing of Nespresso, fueled by Nespresso's ultra-high margins.

On the other hand, since many of the retailers are selling high volumes of Nespresso machines, they are not too keen to put own marketing effort into the sale of capsules of other brands.

Therefore, it is not a recommendable decision for Nespresso to abandon its multi-channel direct distribution to the customer, since the volume gain in sales would not compensate the significant loss of margin that would have to be transferred to the retailers. Conflicts with club members who feel they lose the exclusiveness of the access to the product would be another negative impact of this decision.

The number of own stores or boutiques should be increased significantly in order to obtain a better coverage in existing markets and penetrate into new developing markets with increasing purchasing power.

THE PROMOTION

Knowing its leading position, the timing of Nespresso's marketing efforts should take into account the launch of Sara Lee and other strong competitor capsule brands to counteract and absorb the social impact of upcoming brands in the media.

Having said this, and in terms of a marketing strategy, Nestlé is very strong in its Focused in Market promotion strategies.

Having said this, and in terms of a marketing strategy, Nestlé is very strong in its Focused in Market promotion strategies basing its promotion in the market orientation.

Another key point that Nespresso should implement as a promotion strategy is the use of the emerging social media as both advertising channel and CRM `data base` or source. Social Media is becoming to grow in importance for businesses which are looking to gain a deeper knowledge of the general public and its potential customers as well as the wants and needs from a everyday younger consumer public. Furthermore, the expansion and reach that Social Media has in today's global society is a key factor to take into account in almost any possible sector.

Conclusion

Throughout this essay, the question **'Given its success factors, should Nespresso implement strategic changes in order to tackle the increasing competition?'** has been answered by means of extended research and the detailed study of the coffee market, Nespresso's key factors to success and the analysis of the competition.

In answering the question, this essay profoundly evaluated Nespresso's potential strengths exemplifying the effectiveness of its direct distribution methods and premium pricing strategies, as well as setting Nespresso's customer policy as an example of excellent Customer Relationship Management.

On the other hand, the analysis of the market trends and the emerging competition exposed the threatening weaknesses which the Swiss brand has to correct in a future. It also showed the importance of Corporate Social Responsibility and ethics within the strategic decisions of the companies and focused on the environmentally problematic aluminum capsules as one of the factors that Nespresso has to change in order not to lose customers in a world that turns 'greener' everyday.

Overall, after the detailed research and use of appropriate analytical tools, this paper clearly demonstrates Nespresso's need to carry out strategic changes to overcome the threatening and highly diversified emerging competition.

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Appendix I - Nestlé's income statement for the year 2011

Consolidated income statement for the year ended 31 December 2011

In millions of CHF	Notes	2011	2010 ^(a)	2010 ^(a)	2010 ^(a)
		Total	Continuing operations	Discontinued operations ^(b)	Total
Sales	3	83 642	87 906	5 109	93 015
Other revenue		128	109	—	109
Cost of goods sold		(44 127)	(44 776)	(1 074)	(45 849)
Distribution expenses		(7 602)	(7 953)	(125)	(8 079)
Marketing and administration expenses		(17 395)	(19 846)	(1 276)	(21 122)
Research and development costs		(1 423)	(1 403)	(479)	(1 881)
Other trading income	4	51	168	—	168
Other trading expenses	4	(736)	(1 530)	—	(1 530)
Trading operating profit	3	12 538	12 676	2 156	14 832
Other operating income	4	112	38	24 635	24 673
Other operating expenses	4	(179)	(571)	(14)	(595)
Operating profit		12 471	12 143	26 677	38 820
Financial income	13	115	72	22	94
Financial expense	13	(536)	(834)	(13)	(847)
Profit before taxes and associates		12 050	11 381	26 686	38 067
Taxes	14	(3 112)	(3 343)	(350)	(3 693)
Share of results of associates	15	866	1 010	—	1 010
Profit for the year		9 804	9 048	26 336	35 384
of which attributable to non-controlling interests		317	271	880	1 151
of which attributable to shareholders of the parent (Net profit)		9 487	8 777	25 456	34 233
As percentages of sales					
Trading operating profit		15.0%	14.4%	42.2%	16.9%
Profit for the year attributable to shareholders of the parent (Net profit)		11.3%			36.8%
Earnings per share (in CHF)					
Basic earnings per share	16	2.97	2.60	7.56	10.16
Diluted earnings per share	16	2.96	2.60	7.52	10.12

(a) 2010 restated following the changes in the Income Statement described in Note 1 – Accounting Policies.

(b) Detailed information related to A'con discontinued operations is disclosed in Note 2.