“The business has two - and only these two - basic functions: marketing and innovation. Marketing and innovation produce results; all the rest are costs”.

Peter Drucker
Management: Tasks, Responsibilities, Practices

“To just keep pace in this industry, you need to change at least as fast as consumer expectations. That's renovation. To maintain a leadership position, you also need to leapfrog, to move faster and go beyond what consumers will tell you. That's innovation”.

Peter Brabeck-Letmathe
CEO, Nestlé S.A.

“Individualisation is a driving force in today’s markets - in everything from the telephone to beer to tea to personal computers. The Nespresso System is an innovative concept that offers consumers individual portions of freshly-ground Coffee in a range of tastes that result in an exceptional cup of espresso every time. We're convinced of the power of the idea and the technology behind it, and we're aiming to grow this business eightfold to SFr 1 billion in the next decade”.

Willem Pronk
CEO, Nestlé Coffee Specialties
Introduction

Established in 1986 and headquartered in Switzerland, Nestlé Nespresso SA is an autonomous, globally managed business within the Nestlé Group, the world's leading nutrition, health and wellness company.

The product consisted of high quality coffee packed in aluminium capsules for exclusive use in specially designed machines. Developed at Nestlé, the Nespresso System, as the capsule-machine combination was called, offered the consumer a refined quality and individualised cup of espresso coffee with speed and convenience at the push of a button. In the stagnating global market for coffee, Nespresso had created a new growth segment.

Today Nespresso is an iconic international brand and the company operates in more than 50 countries worldwide. Key to the company’s success is its unique business model, which incorporates its unique Trilogy, its ability to manage and improve quality at every stage of its value chain, and its direct customer relations with all of its more than seven million Club Members around the globe. Over 70 percent of its more than 4'500 employees worldwide are in direct contact with consumers. More than half of new Club Members first experience the brand through existing Nespresso Club Members.

If Nespresso is now the global leader in perfectly portioned premium coffee, it is due to the company’s ability to constantly reinvent itself in its quest for ultimate quality thanks to an unstoppable drive for innovation fuelled by pioneering, team spirit and a passion for perfection. This winning formula has already generated an average annual growth rate of 30% since 2000 and has led Nespresso to become Nestlé’s fastest growing ‘billionaire’ brand.

This case is about the history of Nespresso’s development, the innovation and the ability to constantly reinvent itself.

Part I describes Nestlé’s strategies for growth through innovation and renovation, and traces the history of Nespresso from its uncertain beginnings to becoming one of the fastest growing businesses in the company. This section also describes the management's practices and views on promoting a climate for innovation.
**Part II** explains the challenges facing management as the company aimed to grow the Nespresso business towards the SFr 1 billion level.  

**Part III** describes Nespresso evolution in the last years and the Trilogy Pillar: Quality, Machines and Exclusive Personalized Customer Services.

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1 SFr or CHF: Swiss Franc. 1 CHF = 0,85 euros (85 cents) / 1 CHF=1,06 US$ (May 2012)
PART I
Nestlé and the History of Nespresso

Established in 1867 in Vevey, Switzerland, by 1999, Nestlé was the world's leading food company, employed over 225,000 people, had sales of more than SFr 70 billion, and operated 495 factories in over 80 countries. Peter Brabeck, who took over the reins in June 1997 from long-time CEO Helmut Maucher, believed that continuous innovation and renovation would be the keys to meeting the company's ambitious 4% growth target in an industry where the norm was half that level. While changing demographics and lifestyles in industrialised countries, where Nestlé generated the bulk of its sales, meant opportunities for new business development, these markets were also increasingly characterised by discriminating consumers, powerful retailers, growth of private labels, and pressure on prices and margins.

In seeking new growth markets for its existing products, Nestlé had recently launched its strategic brand Nescafé, the pure soluble coffee that the company had invented in 1938, into the much wider area of ready-to-drink coffee beverages. Similarly, Nesquick, the company's global brand for chocolate powder, was extended into new liquid forms. In addition, a completely new product concept, a re-mineralised table water marketed under the brand Pure Life, was successfully tested in a number of markets in Asia and Latin America. For Brabeck, these were examples of new concepts that combined technological and market innovation. Brabeck commented:

*The success of leading brands is proportional to their capacity for innovation and renovation. Innovation is taking something into the next category or inventing a whole new category. Renovation is keeping the product in the same category and improving it. These concepts are not only technical and production-related, but must be applied throughout our business: from organisational structures to finance, administration, marketing, communication, etc. To make a quantum jump into another direction, we need to look for new opportunities and we must be prepared when they arrive.*
In Brabeck's views, certain management qualities were prerequisites to attaining the company’s growth targets. These qualities were used as criteria by senior management in appointing individuals to important positions (refer to Exhibit 1). Although Brabeck was patent, he was not complacent about his objective of long-term growth through innovation and renovation. He remarked:

*Nestlé has the lowest risk profile that a company can have. While we get pressure from the financial analysts to do things differently, the market is finally beginning to understand. We're not interested in compromising long-term shareholder value for short-term share price maximisation. We have a long-term vision for growth.*

In generating growth through highly differentiated new products, Brabeck wondered what policies and practices might be needed at Nestlé to promote a climate for change and innovation. In the same context, he wondered what lessons the Swiss giant could glean from its long learning curve in bringing the Nespresso System to market.

**Nespresso System: Product Innovation Against the Odds**

The Nespresso System consisted of individually-portioned aluminium capsules containing 5 grams of roast and ground (R&G) coffee made for exclusive use in specially-designed coffee machines (refer to Exhibit 2). Hermetically sealed to preserve the freshness of the coffee for six months after production, the Nespresso capsules also had the advantage of being clean and easy-to-use compared to traditional, hand-measured espresso coffee. Each capsule corresponded to a single cup of coffee and worked only in Nespresso machines. Consumers could choose from eight available coffee varieties (refer to Exhibit 3).

The outward simplicity of the Nespresso technology masked its complexity. The coffee-making process involved three stages: *pre-wetting* (where water was sprayed on the coffee to expand it), *aeration* (where air was passed through the coffee to create small irrigation channels), and *extraction* (where water flowed through the coffee at optimal pressure and heat). The extensively researched Nespresso machine contained a chrome-plated capsule holder equipped with a built-in opening and filtering system, a microchip-monitored pump that delivered varying levels of pressure depending on the coffee blend, and a high precision thermoblock system to continuously heat water in the ideal range of 86° to 91° centigrade. This extraction process was seen to be highly innovative, incorporating years of research and learning that would be difficult for a competitor to replicate without patent infringement. The Nespresso concept currently outperformed all competitors in quality and convenience.
Nestlé held the patents for the Nespresso machines but licensed their production to manufacturers who distributed and sold them through selected household appliance retailers. The manufacturers also offered after-sales service. Nestlé did not make any money on the sale of the machines. It was only the sale of the capsules that determined the profitability of the business. Industry analysts estimated that profit margins on the capsules could be as high as 50%.

With its distinctive brand, luxury image, and focus on the small portion of the espresso coffee segment, Nespresso represented a major departure from most Nestlé lines of business reputed for large-scale production and mass marketing. Outsiders sometimes remarked that it was a company for "lifers"—managers who stayed with the company career-long.
The R&D Push

The technology behind the Nespresso System actually originated in Geneva's Battelle research institute. Nestlé acquired the rights to commercialise the idea in 1974. At the time, Nestlé dominated the instant coffee market, which accounted for 30% of coffee consumption world-wide. Instant coffee generated over 80% of the company's coffee sales and commanded large promotional budgets and managerial attention. On the other hand, Nestlé had no significant presence in the much larger R&G segment, which represented the 70% of total world consumption. Furthermore, while the total coffee market was stagnant, even declining in some countries, management realised that a growth opportunity in the "gourmet" segment of the coffee market was rapidly developing in the US and elsewhere. In the same way that Grand Cru appellations distinguished top quality wine from everyday wine, "gourmet" referred to premium-end coffee (e.g., espresso) where special care and attention were devoted to the coffee variety, roasting process, and brewing phase.

The aim of the Nespresso product development was to combine Nestle's R&D strength with its deep knowledge of the coffee business to bring a high quality coffee product to the market. But a number of technical problems had to be overcome first. For example, the projected production costs were too high, the freshness of the enclosed coffee could not be maintained, and the quality of espresso was inconsistent from cup to cup. Nevertheless, a few people in Nestlé's R&D organisation firmly believed in the project and pushed it forward. They improved both the coffee capsule and an espresso machine later produced by Turmix, a Swiss manufacturer. Other problems were resolved in time.

The project gained early support from Nestlé’s food service division, which saw Nespresso as an entry into the restaurant market, thereby positioning Nestlé more strongly in this segment. But in 1982, following a market test with eight automatic machines in Swiss restaurants, that strategy was abandoned in favour of the office coffee sector. Sobal—a Swiss company that distributed appliances and was already present in office coffee—was approached to distribute the Nespresso System (the machine and the capsules) in offices and other institutions.

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2 A "good" cup of espresso was distinguished by its fine taste and its "crema," the visually distinctive creamy foam on the surface, which coffee connoisseurs considered an essential part of the espresso experience.
Nespresso: A "Satellite" Outside of Nestlé's Main Coffee Business

To further develop, produce, and market the Nespresso System, a separate company was created in June 1986 as a 100%-owned Nestlé affiliate, located across the street from the company’s headquarters. It was thought that the new unit, later called Nestlé Coffee Specialties (NCS), would be able to move faster in seizing the market opportunity in the newly-created, individual-portion coffee category. Exclusively responsible for promoting products under the Nespresso brand name, the company could develop its own commercial, distribution, and personnel policies separate from Nestlé. A special production line was opened to make the coffee capsules at the Nescafé plant in Orbe, Switzerland.

Camillo Pagano, at the time senior executive vice president in charge of several world-wide strategic product divisions and business units, commented:

I saw this contraption in Orbe that somebody said was going to be fantastic. I discovered that the R&D team had developed this system without even really talking to the marketing side. There is no doubt that technical development can bring innovation. But internally, there was a lot of scepticism about the possibility to commercialise Nespresso. The business was physically moved out of Nestlé so that it could establish credibility and so that it didn't have to fight against all the company's rules.

People thought I was a 'nut' to spend so much time on this small thing and to support the idea. Nespresso is so different from what the company does in its day-to-day business. I felt that developing this business would take time and patience. You need champions at the top for a new idea. You need to give an idea support against criticism. Any innovation immediately hits resistance in an organisation. Small satellites like this can help people gain insight into how a business could be developed differently. These offshoots provide an opportunity to train and test people. If they make a mistake there, it's not so costly.

The Nespresso System was first launched in Italy, the world's largest espressodrinking nation and in Switzerland, Nestlé's home market. Japan was also later included as it was one of the world's fastest growing coffee markets. Sales initially focused on the office-coffee sector. The Nespresso machines were designed internally by Nestlé and a Swiss design company and manufactured under license by Turmix for European markets. Sobal purchased the machines from Turmix and the coffee capsules from NCS and then sold the two together as the Nespresso System. Additionally, several companies that distributed vending machines in the office sector added Nespresso machines to their product line-up. It was thought that, compared with households, the office segment would be less sensitive to
the relatively high unit price of the machine which, at the time, retailed close to SFr 800. A box of 10 coffee capsules sold to offices at SFr 4.

Worrying Signals from the Marketplace

By the end of 1987 only half of the machines that had been manufactured were actually sold. The company was behind target on sales for both the machines and the capsules. And without the machines, further coffee capsules would not sell. There were also other worrying signs. Machine defects were absorbing a large part of the maintenance and service budgets, which Nestlé was covering in total. Slow sales in non-traditional espresso markets like Japan were also deepening the losses. Arguments were made to bring in someone from the outside with new ideas to save Nespresso from an early death. In 1988, Yannick Lang, a former Philip Morris executive, was recruited to the venture.

Rethinking the Strategy of Nespresso

Swiss-borra and US-educated, 33-year old Lang came into the Nespresso team with a reputation for flair and creativity and a solid commercial and marketing track record, having catapulted the Marlboro Classics clothing line from SFr 20 to SFr 100 million within a few years. Pagano recounted:

*The Nespresso business was at the point where we needed an entrepreneur to take it further. We needed to find somebody who wouldn't react like a Nestlé manager. People in our organisation are good, but at the time, everyone was asking, 'How could we sell this thing in supermarkets?' Nestlé doesn't bring people in from the outside as a common practice, but we needed someone who understood what it meant to sell a premium system-something between Louis Vuitton fashion accessories and Maggi bouillon. This needs a special mentality. What really convinced me was Lang's background, coming from Philip Morris where going into the clothing business was also a stab in the dark; it was not the usual thing to do.*
Rupert Gasser, executive vice president in charge of Technical, Production, Environment, and R&D, to whom Lang subsequently reported, remarked:

Lang was purposely hired externally rather than internally. He was ambitious and strongheaded. He had a strong drive for recognition. He wanted to do something outstanding. Lang had personality; he was a force. And importantly, he did not carry all the trappings of the company history. He was outside of Nestlé’s main coffee structure.

A Strategic Shift to the Household Market

The idea of spearheading the development of Nespresso—a small operation in a separate company with a separate product—was very appealing for Lang. But the team of eight people he inherited were acting in a "skunkworks," and the business was losing money in the office segment with flat sales. Lang soon concluded that the prospects for the Nespresso System in the office sector were limited, but that there was potential, albeit unproven, in the household market. Lang thought that households headed by well-educated, affluent 35- to 45-year-old men and women, who enjoyed drinking restaurant-quality espresso at home, could constitute a profitable segment for the Nespresso System. Market trends evident in the late 1980s supported this idea. Cafés and bistros were opening up across Europe, and the success of gourmet and specialty coffee chains in the US (e.g., Starbucks, The Coffee Beanery, and Caribou) had led espresso to be perceived as a trendy, socially elite drink. The vast majority of espresso drinkers tended to be city dwellers with discerning tastes in food. The growth in popularity of Italian lifestyle, cuisine, and fashion had also fuelled interest in this method of extracting what was said to be the best aromas and positive components of coffee.

Lang believed that to build long-term business with such discerning consumers, Nespresso had to be in the household market. Lang presented his revised strategy to Nestlé’s general management in early 1989. Despite substantial internal scepticism about the prospects for the Nespresso System, he received the "green light" to launch the household strategy, but only in Switzerland. The rationale was that it was a high risk strategy that still needed to be proven, and that a single market could be shut down more easily than multiple markets. If Lang could deliver on his target to triple the sales volume within a year, the top management agreed, then the business could continue.

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Very little market research on the household market existed at the time. What research had been done indicated low potential for the Nespresso concept. Some data showed that the perceived consumer value of the coffee capsule could not exceed the low figure of 25 centimes (as opposed to the target consumer price of 40 centimes). A market test with five upscale household appliance stores in Switzerland was similarly disappointing. The objective was to sell 100 Nespresso machines through intensive retail merchandising and demonstration. The actual sales, however, were less than half of the target. To avoid being shut down, Lang interpreted the market test results he presented to corporate management rather liberally, i.e., his presentation showed a more favourable picture than the evidence suggested.

Although most people in Nestlé considered the commercialisation of Nespresso to be impossible at the time, the Nespresso team was completely convinced of its potential, despite the grim market research findings. Pointing to the failure of the first market tests for fax machines and mobile phones, their attitude was that consumer research tends to reflect past experience—which does not necessarily lead to innovation. The continuing conviction of Lang and his team was based on intuition and a strong personal belief in the Nespresso System.
Positioning Nespresso at the Top

Lang's new strategy involved positioning Nespresso away from the more utilitarian office coffee and targeting consumers at the top of the household market. Nespresso machines would be produced in Switzerland under exclusive agreement with a leading manufacturer of espresso machines. Nespresso machines were sold through selected household appliance retailers, department stores, electrical outlets, and kitchenware stores. Nespresso machines retailed in the range of SFr 350 to SFr 900. Retailers earned a 25% to 35% margin on the sale of the machines. Machine makers earned a 30% to 35% margin, typical for a product of this type. Again, Nestlé did not profit from the sale of the machines. To accompany his global ambitions, Lang subsequently developed "machine partnerships" with several international producers and distributors of household appliances like Matsushita, Krups, Philips, Alessi, Jura, and Magimix.

During this period, Lang and his team introduced modifications to the design of the coffee capsules that cut material costs while making them recyclable.

Gasser commented on the new strategy:

There were not many people in the company who believed in Nespresso, but Lang did. He was totally convinced of the opportunity. Nespresso was purposely run at arm's length and not built into Nestlé's main coffee structure. Our CEO challenged Lang a lot. He found the challenge motivating; he liked it.

Individually-portioned coffee was an idea mainly pushed forward by R&D. There was a lot of internal criticism at the time, but the project got support from Nestlé's CEO, who dared to do something different. When something is new, it will always meet with resistance. There will always be a lot of ifs and buts. Most people didn't think Nespresso would be a revolutionary idea. There was a concern that it would distract us from our core business in instant coffee. It was seen as competition to instant coffee.

Debut of the Nespresso Club

The shift to the household market soon led to a re-evaluation of the strategy for distribution. The idea of channelling capsule sales through supermarkets was explored but rejected as Lang felt that this would simply transfer the profitability of the business away from Nespresso. An earlier attempt to sell the coffee capsules in US food outlets had actually failed because the consumer base had not been broad enough and retailers had been left with a considerable stock of stale coffee.
capsules. Experience showed that it could take up to three months for the Nespresso capsules to arrive on store shelves, cutting in half the time remaining until the best-before expiry date. With such a short shelf-life, quality could not be assured.

As there were still some nagging problems with the reliability of the Nespresso machines, and quick service turnaround was considered critical, Lang seized on the idea of using a direct marketing channel to stay close to the consumer. Turning a technical constraint into an elegant marketing solution, Lang conceived and launched the Nespresso Club, which, in addition to handling service calls, offered consumers:

- Around-the-clock order-taking: Consumers could telephone a national call centre 24 hours a day, 7 days a week. Orders for Nespresso capsules could be placed by toll-free telephone, fax, mail, and eventually over the Internet.

- Prompt delivery of fresh coffee: Within two business days.

- Personalised advice: Trained coffee specialists were on hand to advise consumers about the different flavours and provide technical assistance on the machine. Club members could also benefit from recipe suggestions, Nespresso accessories, special offers, and get information about new coffee blends.
Lang also put in place some stringent operating rules. For example, in the Nespresso Clubs, telephones had to be answered within three rings, and he insisted that staff and managers dress in a way that reflected well on the luxury image of the system they were selling.

The Club was an immediate success. Purchasers of the Nespresso machines, sold through household appliance stores, automatically became members of the Nespresso Club. The Club concept was the first direct marketing experiment within the larger Nestlé organisation. In 1990 there were 2,700 Club members in Switzerland, France, Japan, and the US. In that year, the stretch sales targets set a year earlier had been surpassed. Nespresso Clubs were later established in Germany and the Benelux (1992) and in Spain, Austria, and the UK (1996). The Nespresso System was also available through agents in the Middle East, southeast Asia, and Australia.

**Spreading the Word**

As part of the strategy to further internationalise and position the Nespresso System as a premium product, the company sought the patronage of British Airways, Cathay Pacific, and Swissair, amongst others, which began serving Nespresso coffee on board their long-haul first class flights. Top restaurants, mostly in France and Belgium, were also solicited. In countries where Nespresso Clubs existed, heavy investments were made in training sales clerks in retail stores where Nespresso machines were sold. Experience showed that sales clerks needed to give a high level of attention to consumers in order to sell the Nespresso machines. The training and financial incentives were seen as keys to supporting and motivating retail clerks to demonstrate and sell the machines.

Despite the step-by-step international growth, no major advertising or public relations campaigns were undertaken. The Nespresso Club was the chief means of communication. The company relied mainly on word-of-mouth on the part of its extremely loyal consumer base to promote the Nespresso System. Alfred Yoakim, who had been part of the original Nespresso product development team, said:

> Advertising is good for the image. It can reassure consumers and communicate an image of quality. But I'm not convinced it will make a consumer change to espresso and buy the Nespresso System. For this, we can only rely on word-of-mouth.

Rupert Gasser concurred:

> We don't need mass media or television. We're targeting the crème de la crème. We need simpler means, unconventional ways of reaching new consumers.
Achieving Growth and Profits

Under Lang's leadership, NCS achieved breakeven in 1995 and subsequently became one of the fastest growing business units in the Nestlé organisation. By 1997 Nespresso Club members numbered 220,000 (reflecting a 30% average yearly increase), the company's ristretto variety had won special recognition from the International Institute of Coffee Tasters, and the company had installed a second production line for the capsules and was manufacturing them around-the-clock.

Lang was known as a tough manager by the team of "young tigers" he had built, some of whom he had hired away from first-class consumer goods companies. Lang was also known as a strong-willed person who did not give up easily. People recalled that every win gave him a boost. He resisted all efforts to apply methods that might lead to risk-avoidance as he felt the Nespresso business had to go on taking risks. However, some who worked closely with Lang found his strong-headedness a barrier. In the words of one of his associates:

He was passionate about his own ideas but not those of his colleagues. He was impatient, wanting to make things happen in no time. He was a tough boss, a difficult person to work with and manage.

Creating a Climate for Innovation

Different opinions were expressed regarding what the experience of bringing the Nespresso System to market meant for the larger Nestlé organisation. Lang believed that he had created an environment where his team could take intelligent risks and where everyone could be an innovator. Lang felt that if he had stuck to an "army-like structure," Nespresso would have failed, as he believed that anything military-like would stamp out innovation. For him, having an infantry that marches when it's told to march and assumes that the chain of command knows best, would not lead to innovation. Lang was known to accept structure where it served his purpose and "helped people to do a good job." He rejected it in instances where "it stopped people from innovating."

Lang went to great lengths to keep the Nespresso concept alive, sometimes doing things at the edges of the Nestlé organisation. He also established privileged contacts with high level members of the top management. Former executive vice president Pagano, who before his retirement at the end of 1991 held private discussions with Lang, remarked:
Nespresso was developed as a totally innovative system. Lang crafted a strategic image that was consistently carried through. At one time, he was so convinced of the concept's potential that he even tried to buy Nespresso.

Pagano felt that an individual's personality was tremendously important with respect to innovation:

It's not necessarily the inventor of an idea who has the capability to take it forward. This needs courage, leadership, temperament, and charisma. An organisation also needs to build in the right to make mistakes. This message is not always going down through the 'bunker' of our middle ranks. It's stuck or not being properly explained. Nestlé needs people who can take an idea, believe in it, and bring it to fruition against the odds.
Rupert Gasser, who had overseen the entire Nespresso development and believed in giving broad responsibility to risk-takers, the "youngsters" as he called them, offered his insights into the innovation process at Nestlé:

> Our problem is not a lack of good ideas. We have too many of them. The key is to be able to extract an idea, carry it forward in the organisation, and transform it onto the supermarket shelf. The real barrier to innovation is perceived risk. People ask themselves, 'Why should I engage in a process with an uncertain outcome?' People reject risk-taking because they feel it can endanger their current status, their jobs. At Nestlé, we need to create a risk-friendly environment where people don't feel unduly exposed. We must accept that people make errors. But failure due to trying something new shouldn't be a career risk. Sometimes you have to shelter the real innovators, the risk takers.

At the same time, Gasser believed that innovators needed to be occasionally challenged to make sure they had not ignored important details. He said:

> Sometimes people who push for innovative ideas forget some basic things. But by being challenged in a dialectic process, they improve their solutions. It's a positive process.

Gasser recognised that innovation in a large corporation like Nestlé was a complex process:

> Growth through acquiring brands and companies is relatively low risk. Building new business is different; it's more complex and carries higher risks. In our company, we must be able to get R&D, manufacturing, and the local Nestlé market companies to work in close proximity. This needs to be a constructive process; otherwise, innovation will not be successful.

He agreed that innovation and renovation were both necessary for Nestlé:

> To stay viable in the long-term, we need both innovation and renovation. Innovation is a quantum leap that is not necessarily only related to products. It can also be related to manufacturing process improvement or trade channels. Renovation, on the other hand, is more incremental; it allows you to sharpen your claws every day.

At Nestlé, identifying high potential individuals who would foster change and innovation was a senior management responsibility.

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4 Innovation and renovation referred to radical and incremental changes respectively
Brabeck personally followed the careers of several individuals with the aim of picking the right people for tough assignments and helping them to grow in their jobs. He believed that Nestlé needed managers to keep the core businesses running, who would assure order and discipline and provide security and longevity. But he also saw the need to provide space for what he called "change drivers." But this change was complex. Brabeck explained:

You can't impose change from the top. You can only create an environment that stimulates change. Many managers in large institutions have been trained to keep things running as they have been. They have learned to comply with an enormous number of detailed procedures and systems. They were taught by experience that they are better off following the expected and accepted tracks of routine rather than venturing out into the new and unexpected.

We need to create a climate where there is a certain freedom to fail, and where those people who are promoted have made decisions and carried them out, even if they were not always 100% successful. We don't want to advance the careers of these who have never made a mistake because they've never done anything except apply the rules. We have to identify, foster, and mentor people who have provee that they're willing to stick their neck out, who made a mistake, learned from the mistake, and are willing to continue taking risk.
On the other hand, Brabeck observed:

*If you're only being innovative and creative, but not producing reliable products, you'll soon be out of business. For Nestlé, the quality and security of our products is fundamental.*

For Alfred Yoakim, the head of the Nespresso development team from its early days, there were lessons on innovation from Nespresso's experience:

*By staying in an ivory tower, you can improve an existing product, but you can't innovate. To innovate, you need the freedom to make your own decisions, to not follow the old rules. Marketing people can innovate because they are free of technical restrictions. Technical people can innovate because they are free of commercial considerations. What we have to do is put the two together. There's still room to innovate in the espresso market. The only limit to innovation is our imagination.*

**Nespresso Under New Leadership**

Lang's tenure at NCS was not without controversy. He was thought by some to be a maverick, an "out-of-the-box" manager who forcefully pushed for his ideas, and who found being challenged by his superiors motivating. Gasser called him a real force behind the Nespresso phenomenon and a "raye bird." Lang was subsequently nominated to a select list of managers whom Nestlé considered as "corporate assets." Late in 1997 an opportunity came along for Lang to move to the US to work on Nestlé's large but under-performing ice-cream business. The appointment was considered by everyone, including Lang himself, a timely career move. However, less than six months later, Lang announced that he was leaving Nestlé, having been headhunted by another food company.

In the eyes of Nestlé's top management, NCS had now reached a critical stage in its evolution needing to shift gears for sustained future growth. In the words of Gasser:

*The challenge for any small, innovative organisation is to make such a transformation. Nespresso needed structure, better operational efficiency, control of costs, quality, and inventory, in addition to moderate personnel policies. As the company grew, these issues became increasingly important.*
Willem Pronk, 44, a career-long Nestle manager, was appointed to spearhead the transformation at NCS. He was considered to be a very structured manager and a good marketer.

For Nestlé's CEO, Nespresso's development reflected solid technical know-how combined with the marketing spark of an individual embedded in a supporting organisation. Brabec commented:

There was a long learning curve to transform the Nespresso innovation into an acceptable, perceivable end-product for the consumer. With Pronk, we've agreed to take the business from the SFr 150 million where it stands now to SFr 1 billion within the next 10 years. Then it becomes an interesting business for a company the size of Nestlé.

At the start, we realised that we had to separate this business so that it could develop its own life. At a certain point, a different management style was needed. Not everyone is good for all phases of a business. As a group, Nestlé has the resources to cover the whole spectrum. In a crisis moment, we may bring someone in from the outside, but normally we try to avoid this. We're not looking for saviours. We look for people who will become long-term collaborators at the service of the company.
PART II
Towards the One-Billion Target

Pronk Takes the Helm

In his own words, Willem Pronk was "born in Nestlé." Over the course of his 20odd year career at Nestlé, Pronk had developed a reputation for being an innovator and a risk-taker. While managing Nescafé in the Netherlands, for example, he had introduced a new "café a la carne" concept to rejuvenate the brand's stagnating business in that market. Despite the scepticism of his superiors, he had allocated an entire marketing budget to promote the new concept: a selection of different Nescafé blends in a stylish wooden box. The concept worked with spectacular results, pushing sales up by more than 200%. This and other moves brought Pronk to the attention of headquarters. He quickly began to climb the Nestlé ranks. Reflecting on his early days in Nestlé Netherlands, Pronk said:

As Peter Brabeck says, 'If we had continued to do what we’d always done, we would have continued to have what we always had—an unsatisfactory performance.’ I pushed for trying something new. If it didn't work, the worst case scenario was that I would be fired. But so what? People ask me if it's frustrating to work in a multinational like Nestlé. My answer is: No, I'm probably more frustrating to other managers than they are to me. In a big company like Nestlé, you have access to resources and all the sources of innovation. You can either accept the system or challenge it. There are no hard-and-fast rules. I'd rather ask for forgiveness than permission.

Soon after arriving at NCS, Pronk began working to enhance the consumer service side of the business. The Nespresso Club database was segmented according to consumption habits and the length of membership, and targeted communications were launched. Fifteen to twenty percent of Nespresso capsule orders currently carne from small offices. "New" members (less than a year) were tracked closely as it was felt that their long-term consumption habits were formed by usage patterns established in the first few months. A Nespresso Club staff member personally followed up on "heavy" capsule users (more than 100 capsules per month) who did not place an order by the computer-anticipated date, to ensure that their machine was functioning, take orders, and answer questions. When machines needed service, the Club arranged for free home pick-up and return of the repaired appliance. The machine manufacturer did the repair. A Nespresso machine was loaned free to members during the period.
Pronk believed that the above renovations, among others, were needed to create customer intimacy, build long-term loyalty, and put Nespresso on the road to becoming a meaningful concept in the competitive world of coffee. (Refer to the Appendix for background information on the world coffee market).

**Issues for Growth**

With its 10 existing Nespresso Clubs in 1999, NCS was receiving 7,000 orders world-wide for coffee capsules each day, and had the capacity to produce 350 million capsules annually (refer to Exhibit 4). Close to 100,000 Nespresso machines had been sold in the past year alone, bringing the installed base up to about 350,000. New consumers were also coming on board (refer to Exhibit 5).

While the Nespresso concept had created and dominated an entirely new gourmet coffee category—the portion-coffee market—several issues still had to be resolved if NCS was to accelerate its growth. Pronk was very concerned that NCS had, to date, only achieved an average awareness rate of less than 5% in its international markets, and penetrated less than 1% of households. Some asserted that these ratios were significantly higher among upscale households, the current target segment for Nespresso. Nevertheless, the fact remained that very few coffee consumers actually knew about the Nespresso System.

Pronk saw the individualised portion concept on which the Nespresso System was based as a vital means for rejuvenating the mature coffee market. But little market research had been undertaken to date. Pronk remarked:

> The quality of the future depends on the quality of the plans you put into action today, and the information on which they are based. That's why market research is key. For me, this isn't about getting reports; it's about being present during the interviewing and being totally immersed with the consumer. We need to know three things: Why do people buy our product? Why do they buy a competing brand? And why don't they buy any product in this category? Then we can look at the three ways to grow the business: sell more to current consumers, sell to consumers of the competition, and sell to non-category users.

Looking to the future, Pronk was concerned about five issues: how to attract new consumers, whether to introduce a lower-cost system, how
to serve a wider market, whether to diversify into non-coffee products, and how to pre-empt competitors.

1) Attracting New Consumers

Most people drank espresso "away-from-home" in restaurants, hotels, bars, and from vending machines in offices and public areas. Home consumption was limited, in part, because of the perceived high price of espresso-making machines. In Italy, espresso was inexpensive at 1,000 lire (SFr 0.75) a cup and widely available at the neighbourhood bar. Only 1 in 5 Italian households consumed espresso at home. In France, the world's second largest espresso-drinking nation, 66% of adults regularly drank espresso but only 12% drank espresso at home. In northern countries, like the UK and Germany, espresso-drinking was in its infancy, but growing. Most US households still used electric drip coffee makers.

Less than 1% of US consumers had an espresso coffee machine at home. Pronk reflected:

*The Nespresso System guarantees high quality and offers consumers individual choice, consistency, and conveniente. These are the values of the future. One type of coffee for all is an old-fashioned concept. But despite the success of the Nespresso Club and our comprehensive knowledge of consumer preferences as a result of it, our awareness remains low in priority markets. Word-of-mouth is a slow process. We have to find other means of making the Nespresso concept known.*

One idea that had been implemented a few years ago was to give free machines and coffee capsules to opinion leaders, like politicians, journalists, etc., in key markets. This was thought to be less expensive than a media campaign.

Until now, little advertising had been used to raise consumer awareness about Nespresso. Old timers like Alfred Yoakim were strongly against the idea. He said:

*Advertising won't do us any good. It's just a waste of money.*

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Camillo Pagano was also cautious about the new growth strategies being discussed. He said:

*I'm worried about the mass marketing mentality that is entering the picture. In this business, you can't talk about household penetration and market awareness.*

To promote the Nespresso concept and sales of the machines, NCS continued to invest significant resources (upwards of SFr 200 per machine sold) in training retailers and doing merchandising and in-store promotions. Recent studies had shown that retail demonstration accounted for 40% of new converts to the Nespresso System. The remaining 60% of new customers came through word-of-mouth. In spring 1998, 2,100 Nespresso machines had actually been given away free to Belgian retailers as part of an incentive programme initiated by General Electric Belgium. Upon seeing that 55% of these new machine owners never called the Club to order coffee capsules and a year later, only 26% of the target group were active customers, Pronk noted:

*The experience confirmed what we already knew: that people to whom the Nespresso System is targeted must have a desire to drink espresso coffee. If we promote the machines too much, we'll succeed in getting people to buy the machines, but not the complete concept.*

**2) Going Down Market?**

By most measures, the Nespresso System was more expensive than alternative methods of making coffee. Compared with the cost of traditional filter coffee machines, the Nespresso machine was five times more expensive. Compared to regular espresso coffee, Nespresso coffee was three times more costly. Yoakim said:

*Like all espresso machines, the Nespresso System is targeted to an affluent group of consumers, the top 10% of households. If they can afford the espresso machine, they can surely afford the coffee capsules. We're not selling a machine and then a capsule. We're selling a result: a cup of espresso. And I want the consumers to get the best result in their cups.*

Pronk was adamantly against offering a lower-priced system and the idea of marketing the system under a different brand name. He believed there was still enormous growth potential in Nespresso's current strategy.
3) Distribution to Serve a Wider Market

In markets like Switzerland, where a critical mass of consumers had been created, retailers had approached NCS about the possibility of selling the high-margin capsules. Going through traditional food retailers would be a departure from the past, a move Pronk was not entirely convinced of.

*If we give away 25% margins to retailers, there won't be much left here to show for profits. Besides, the Club gives us a fantastic knowledge of consumers that would be lost if we went through retailers. On the other hand, if we continue to sell exclusively through the Nespresso Clubs, non-users won't see the product.*

Another idea was to showcase the Nespresso concept through a chain of exclusive boutiques established in high street locations in major European cities. It was estimated that each boutique would involve a one-time investment of SFr 250,000.

4) Diversification into Non-Coffee Products

New uses for the Nespresso System based on the "portion" concept had yet to be explored. For instance, individually-portioned soups or teas could broaden usage among current consumers and attract new consumers. The idea of non-coffee products was not very popular, however. Pronk and Gasser were both concerned that such a product extension would dilate the original concept.

5) Blocking Competitors

NCS currently held a 90% share world-wide in the household segment of the portion coffee market, with Switzerland, France, and the Benelux being its most important markets. The remaining 10% share mainly belonged to Belgium's Malongo with its 1,2,3 Spresso system and Italy's Illycaffé, which had yearly sales of US$ 130 million. Having pioneered the ESE Standard (Easy Serving Espresso), Illycaffé had begun supplying "L'Espresso" portions and its own espresso machine to hotels, restaurants, and bars. The company dominated this sector in Italy but was less established in the mass consumer market. Since 1994, Lavazza, a family-run Italian company with US$ 700 million in annual turnover, had marketed tour individual portions, containing 6.5 grams of ground espresso coffee, custom-made to fit its own espresso machines. Close to 80% of Lavazza's sales were in the office coffee...
These companies had entered the portion coffee market with lower-quality products and espresso-making machines retailing in the range of SFr 300 to SFr 350.

Although the technical complexity of the Nespresso System and related patents were major barriers, the NCS team was convinced that international food companies with their large resources could challenge Nespresso's dominance by extending their long-established R&G brands into the portion coffee segment. In fact, NCS had learned that Sara Lee had recently registered a patent for a portion coffee concept with a different extraction process, which was as yet commercially unproven. In 1997 Kraft Jacobs Suchard had expanded its Carte Noire line in France to include "Espresso Dosettes Filtres." Additional developments were also underway that catered to the single-person households in NCS's target group for espresso drinkers.

Pronk expected a serious entry by one or more players into the high-quality, portion-coffee market where Nespresso was currently positioned. Nevertheless, he believed that NCS had several advantages: advanced technical knowledge, the Club, and a critical mass of consumers in some of its international markets. It was estimated that it would take a newcomer four years to establish a foothold in any national market, and a minimum of 15,000 to 20,000 installed machines to break even.

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PART III
Towards the Three-Billion Target

The One Billion brand

At the end of 2005 Nespresso had 19 subsidiaries, 1,345 employees, 9 machine partners and 135 machine versions with 16,881 machine points of sales, was present in 48 countries with 42 boutiques and 2,200,000 active members.

In 2006 Nestlé Nespresso SA exceeds CHF 1 billion in revenue for the first time. George Clooney becomes the global Nespresso brand ambassador and stars in the first of a series of celebrity publicity campaigns. The Le Cube machine sets new design standards with its minimalist lines and square shape. An innovative range of flavoured coffees is introduced as a year-end offer. Company Emphasizes Quality and Customers as Key to Global Expansion.

This achievement marked the sixth consecutive year that Nestlé Nespresso enjoyed sales growth rates above 30%, making it the fastest growing business in the Nestlé group and the latest addition to its set of "billionaire brands".

As a result, Nestlé Nespresso was on target to achieve 2 billion CHF in revenue by 2010 and poised to fulfill its ambition of becoming the Icon for Perfect Coffee Worldwide.

2006 marked a number of significant performance milestones for Nestlé Nespresso, indicating that the Company will continue to deliver vigorous growth in all areas of the business:

- Overall sales growth of 42%, to 1.16 billion CHF, up from 819 million CHF in 2005 - a Nespresso record above its sales target of 1 billion CHF.

- The number of coffee machines sold in retail distribution outlets increased by 32% to over 1 million, thereby expanding Nestlé Nespresso's global leadership position in the espresso machine market with an increase of 4.8% points to 22.7%.

- Over 1.1 million new Club Members were acquired in 2006, compared to 770,000 in 2005, bringing the total number worldwide to more than 3.1 million.

Gerhard Berssenbrügge, CEO of Nestlé Nespresso said:
“The Nespresso trilogy of highest quality Grand Cru coffees, smart and stylish machines and exclusive customer services has been the key to our success. Moving forward, our commitment to highest quality will continue to be the Company’s cornerstone for achieving successful, sustainable growth on a global level. We will demonstrate this through our customer-focused business model, our constant innovation and our strategic entry plan into new markets”.

Setting the foundation for its vision, Nestlé Nespresso has explored new ways to exceed the expectations of a growing number of coffee connoisseurs in 2006, while expanding brand visibility on a global scale:

• Opening 39 Nespresso Boutiques, Boutique Bars and Boutiques-in-Shops, which brought the world wide total to 79. Highlights include a flagship location on New York’s Madison Avenue, plus for the first time, a Nespresso presence in Central Europe and South America.

• Introducing George Clooney as the first official Nespresso ambassador resulted in a widely successful premiere celebrity campaign.

• Launching the Nespresso Siemens Essenza, Le Cube and the Siemens by Porsche Design machines offered customers a complete range of functionality, design and price points.

• Concluding its third year of successful collaboration with the Rainforest Alliance non-governmental organization on the Nespresso AAA Sustainable Quality(tm) Coffee Program, which ensures farming practices that lead to the highest quality beans and economic viability, whilst contributing to the well being of farmers and their communities. As a result, Nespresso was able to grow its share of green coffee sourced from the Program by 10 percentage points to 30%.

New Strategic Direction for Nespresso

According to AC Neilsen Europe & North America, the segment share of portioned coffee in 2006 was still only at 3% by volume and 7% by value of worldwide coffee consumption, which provides great potential for future Nespresso business development plans. In fact, the Company expects that the share of portioned coffee worldwide will double by 2010, the same year Nestlé Nespresso is positioned to achieve 2 billion
CHF in revenue. This would complete Phase IV of the Nespresso Global Expansion Plan, which the Company began in 2006.

Gerhard Berssenbrügge, CEO of Nestlé Nespresso said:

“Despite increased competition, I am confident that our 20 years of experience as the only super premium brand in the portioned coffee category gives us valuable knowledge to draw on. The fundamentals of our strategy have been proved right by our excellent performance in 2006. Our expansion plan is aggressive, but sustainable, and I am confident that Nestlé Nespresso will achieve its next important milestone of 2 billion CHF in 2010”.

To fulfill its three-year revenue objective, as well as its strategic vision of becoming the Icon for Perfect Coffee Worldwide, Nestlé Nespresso set the following critical business targets for 2007:

• Maintain highest quality in all elements of the Nespresso value chain. This year, it will break the ground for a new state-of-the-art Production and Distribution Centre in Avenches, Switzerland, investing 150 million CHF to underpin global growth with consistent Swiss quality;

• Continue its successful Nespresso AAA Sustainable Quality(tm) Coffee Program, which will see an increase in coffee from this source, from 30% in 2006 to a target of 50% in 2010;

• Place additional focus on the business-to-business area to allow more customers the opportunity to enjoy the Nespresso Ultimate Coffee Experience wherever they are - at work, traveling or at leisure in high-end restaurants, luxury hotels and boutiques, offices, or when flying first class;

• Open more than 40 new Nespresso Boutiques, Boutique Bars and Boutiques-in- Shop, to take the total to 120 locations:

  o Including the first Boutique Bars in new markets, such as Singapore, Shanghai, Beijing, and Dubai where the role of the Boutique Bar as a brand exemplar will signal a new approach to market entry;

  o Including further expansion with a global flagship location on the Champs Élysées, which with a size of 1’500 m2 will bring a new dimension to the brand that promises to engage and delight customers.

  o Introduce the new Nespresso Lattissima one-touch milk froth machine in cooperation with De'Longhi to satisfy
consumer demand for espresso based fresh milk beverages.

Gerhard Berssenbrügge, claimed:

"Nespresso delivers coffee aficionados around the world excellence in every cup, every time. We will do the utmost to ensure that our trilogy of Grand Cru coffees, innovative machines and second-to-none customer service meets and exceeds our customers' expectations as we commit to double our business by 2010."
The Nespresso Trilogy: 3 Pillars of Excellence

The Nestlé Nespresso S.A. story began with a simple, but revolutionary idea: enable anyone to create a perfect cup of espresso coffee – with exquisite crema, tantalizing aroma and full-bodied taste – just like skilled baristas. Through a passionate pursuit of excellence, driven by non-stop innovation and an unfailing commitment to highest quality, the company pioneered and perfected the concept of portioned premium coffee. Today Nespresso is well on its way to becoming an iconic global brand by consistently delivering optimum coffee enjoyment and maximum convenience to consumers around the globe, both in the comfort of their own homes and in leisure and work venues outside of the home.

Nespresso is now the reference for premium portioned coffee worldwide, and at the heart of its offer is the unique Nespresso Trilogy, an unparalleled combination of three pillars of excellence: exceptional Grand Cru coffees, smart and stylish coffee machines and personalized, exclusive services. Blended together, these deliver Nespresso Ultimate Coffee Experiences – moments of genuine pleasure and pure indulgence designed to continually delight coffee lovers wherever, whenever and however.

Trilogy Pillar 1: Perfectly Portioned Highest Quality Grand Cru Coffees

Nespresso is committed to offering its consumers only the finest gourmet coffees. Only the top 1% of the world’s green coffee crop meets Nespresso specific taste and aroma profiles. Throughout the year, Nespresso green coffee experts and their green coffee supply partners ensure these highest quality standards by actively seeking out such coffees cultivated in farm communities in the world’s premium coffee-producing areas. These are often remote regions, where a delicate combination of altitude, climate and rich soil produce the distinctive flavours, aromas and complex character that make up Nespresso Grands Crus.

Once the beans are selected and transported to the state-of-the-art Nespresso Production Centres located in Avenches and Orbe, Switzerland, expert staff apply extreme care and skilful attention to precise blending, roasting, and grinding phases of the production process. Ultimately, during final packaging, the coffee is hermetically sealed in 100% recyclable aluminium Nespresso capsules to keep all air, light and moisture at bay. All of the aroma, freshness and flavour of the perfectly roasted and ground Grand Crus are absolutely preserved, awaiting release for consumers to enjoy.

The Nespresso Grand Cru coffee range offers distinct aromas and flavour notes to appeal to a wide range of preferences. Just as with fine...
wine, each Nespresso Grand Cru offers unique aromatic notes – from roasted to woody, cereal, buttery and fruity-winey and citrus – to meet individual preferences and tasting occasions. Just as with fine wine, each Nespresso Grand Cru offers distinct aromas and flavour notes – from roasted to woody, cereal, buttery, fruity-winey and citrus – to meet a wide range of individual preferences and tasting occasions. The full coffee range comprises:

- **A permanent collection of 16 premium (B2C) coffees for enjoyment at home**: 7 Espresso blends (best enjoyed in a 40 ml cup), 3 Lungo blends (mild but intense coffees for enjoyment in a larger 110 ml cup), 3 Decaffeinated blends (2 Espresso, 1 Lungo) and 3 Pure Origins (three extraordinary espressos, each exclusively composed 100% of coffees sourced from a single country of origin).

- **A permanent collection of 7 premium (B2B) coffees for enjoyment at leisure and work**: 7 premium Grands Crus specially packaged to work in Nespresso B2B coffee machines.

- **Exceptional specialty coffees**: two extraordinary and rare Nespresso Grands Crus are typically introduced for a limited period each year: the Limited Edition (spring) and Special Club (autumn) blends offered in both the B2C and B2B channels.

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Nespresso maintains its unparalleled level of coffee quality thanks to long-term relationships developed with farming communities where the world’s finest coffee is produced. In 2003, Nespresso established its AAA Sustainable Quality™ Program in collaboration with Rainforest Alliance, through which only the highest-quality beans are sourced and where farmers are paid a premium. In 2009, 51% of the total green coffee beans Nespresso purchased came from its AAA Sustainable Quality™ Program, and Nespresso has committed to increase this to 80% by 2013.

**Trilogy Pillar 2: Smart, Stylish Coffee Machines**

Following expert selection, blending, roasting and grinding, the true personality and soul of an exceptional Grand Cru coffee can only be revealed thanks to the precise extraction offered by technically advanced machines that produce consistently perfect coffee.

Brilliant in their unparalleled ease-of-use and simplicity, their advanced technology and their distinctive design, Nespresso system machines
have fundamentally transformed the preparation and enjoyment of espresso-based drinks. Complete with a patented extraction and brewing system, with its 19-bar pressure pump and sophisticated capsule, Nespresso system machines manage the interplay of all of the factors necessary to produce perfect coffee — with all the exquisite crema, tantalizing aroma and full-bodied taste that set Nespresso Grands Crus apart - on every occasion, time after time.

In addition to completely redefining what a coffee machine can be and do, the Nespresso system is continually reinvented for the surprise and delight of consumers. Through this continuous innovation and evolution, Nespresso machines are perfected still further, both in terms of latest technology and cutting-edge design, to meet the changing needs and expectations of demanding coffee and design connoisseurs around the world.

This constant evolution has created many firsts in the exceptional Nespresso history of developing state-of-the-art coffee machines. In the consumer (B2C) market, for example, the Concept machine was the first model to incorporate revolutionary “open jaw” technology to handle the unique Nespresso capsule. From there, the Essenza machine delighted consumers with its compact form and brewing unit and its vibrant colours. Le Cube, then set new standards with its minimalist clean lines and square shape. Lattissima in turn broadened the Nespresso appeal with its one-touch technology offering a wide choice of coffee specialty beverages created with fresh milk.

The latest Nespresso machine innovation, CitiZ, began rolling out in 2009 as the company’s first complete range of coffee machines for home use. Sporting daringly slim, urban and modular design, the range comprises three new coffee machines, all at attractive price points:

- **Nespresso CitiZ** – a single-head automatic espresso machine.

- **Nespresso CitiZ&Milk** – a single-head automatic espresso machine combined with a built-in fresh milk frother.

- **Nespresso CitiZ&Co.** – the first-ever double-headed machine designed to enable consumers to prepare two coffees simultaneously.

At the same time, the range of high performance Nespresso Gemini coffee machines enables out-of-home (B2B) establishments such as offices, gourmet restaurants, premium hotels, luxury outlets and as well as upscale airline services to specially cater their premium coffee offer to their own customers. For instance, the revolutionary Gemini introduced in 2006 includes a double-head brewing system for preparing two coffees at once, as well as a single-head brewing system targeting small-to-medium sized businesses. The range also includes
an optional payment system designed especially for medium-to-large companies.

**Trilogy Pillar 3: Exclusive, Personalized Customer Services – The Nespresso Club**

Completing the unique Trilogy that sets Nespresso apart is the unparalleled dynamic customer experience that Nespresso offers. Exclusive, personalized services are tailored to the specific needs and preferences of its consumers to ensure that they may create and enjoy. Nespresso created its 24-hour information and ordering service more than 20 years ago. Today, Nespresso also offers tailored shopping experiences in exclusive boutiques and through its Internet site as well as direct access to coffee specialists via the Nespresso Club’s Customer Relationship Centres. Nespresso Ultimate Coffee Experiences wherever, whenever and however they desire.

**Nespresso Club – a community of coffee connoisseurs**

Nespresso enjoys exceptional direct contact with its consumers through the Nespresso Club. The company’s personalised customer service and information network perfectly reflects its innovative spirit and focus on highest quality. These qualities link the global community of coffee connoisseurs that make up the Nespresso Club.

This unique and dynamic Club enables the company to establish privileged and direct relationships with its consumers through three interactive channels: its online e-commerce platform (www.nespresso.com), its global boutique network of more than 190 boutiques and its international network of Customer Care Centres. Through these channels, Club Members can access a wide range of information, advice and tailored services around the whole Nespresso offering, as well as a variety of other benefits and special offers. All queries are answered within one working day, and purchased products are automatically shipped to the Club Member’s preferred home or office address within 48 hours.

**Les Collections – exclusivities reserved for Nespresso coffee aficionados. Coffee Accessories**

As an extension of its commitment to offer exclusive services for Nespresso Club members worldwide, Nespresso creates a wide range of luxurious coffee accessories. These enable Nespresso coffee aficionados to personalise their coffee moments in their own unique ways. Ranging from coffee preparation to coffee tasting accessories, these special lifestyle products and food items provide the perfect pairing for Nespresso Grand Crus. From elegant and refined white porcelain tasting sets to sumptuous sweets and biscuits created uniquely for Nespresso by top chefs to and to surprise and tease the
palate, all are designed to delight the senses and thus contribute to creating *Nespresso ultimate coffee experiences*.

Some tasting accessory collections are fashioned in tandem with new espresso machine introductions to highlight and complement the spirit and design of these machines. For example, the versatile CitiZ collection radiates the distinct urban vibe of the CitiZ machine range, with hand-blown coffee glasses, translucent bone china bowls and sleek trays.

**Les Chocolats – a treasure-trove of new sensory experiences**

To extend the coffee tasting experience to new heights, *Nespresso* collaborated with famed Belgian chocolatier, Pierre Marcolini, and with Nestle chocolate R&D and cocoa experts to create a unique collection reflecting *Nespresso* chocolate excellence. The result: *Les Chocolats*, now available in certain countries. This collection includes 10 artisanal recipes of fresh dark, milk and white chocolates in flavour combinations that pair perfectly with *Nespresso* Grand Cru coffees. From filled chocolates such as *Vinaigre de Framboise* to pure origin chocolates from exotic and aromatic lands such as Madagascar, *Nespresso Les Chocolates* are designed to indulge consumers’ taste buds with exceptionally novel sensory experiences.
The Winning Formula – Nespresso Core Competences

Over the past three decades, Nespresso has established itself as a leading pioneer in the global portioned premium coffee market based on its deeply rooted culture of innovation and its firm commitment to excellence in all aspects of its business. Its success is demonstrated by its global market leadership (about 20%) in sales of espresso coffee machines and by its appeal to coffee connoisseurs around the world – more than 7 million of whom are passionate Nespresso Club members.

Every minute of every day, consumers around the world enjoy 10'000 cups of Nespresso Grands Crus – and this number continues to rise thanks to growing consumer enthusiasm for the dynamic Nespresso brand and its ability to continually reinvent itself:

A number of key factors currently drive the Nespresso success story and will continue to do so in the foreseeable future. These reflect well-honed competences of the brand and include:

- Unsurpassed product quality and proven coffee expertise
- Unstoppable drive for innovation and distinctive design together with in-house Nespresso R&D expertise
- Inspirational, iconic global reputation of the brand
- Global brand community thanks to direct customer relationships
- Exclusive routes-to-market
- Expertise in Sustainable Quality development

Unsurpassed product quality and proven coffee expertise

Nestlé Nespresso employees and partners reflect a deep passion to collectively deliver ultimate coffee experiences that are grounded foremost in the perfect cup of coffee with exquisite crema, tantalizing aroma and full-bodied taste. An exceptional team of Nespresso green coffee experts, agronomists, and supply partners regularly criss-cross the globe in search of highest quality beans from speciality farms in the finest countries of origin. To maintain its unparalleled quality, Nespresso has developed long-term relationships with farming communities where the world’s finest coffee is produced. Today, 51% of its coffee is sourced from the Nespresso AAA Sustainable QualityTM Program.

They in turn work with a variety of other Nespresso coffee specialists – coffee sensory, aroma and flavour experts – working in conjunction with state-of-the-art coffee production facilities in Orbe and Avenches, Switzerland. These are the premier coffee “sommeliers” who devote themselves to entire sensory experiences around coffee. Thanks to their efforts, a full range of Nespresso Grands Crus is offered to continually surpass the expectations of the most demanding of coffee connoisseurs.
All across the Nespresso value chain, quality reigns supreme and it is the foremost preoccupation of Nespresso experts in a variety of fields who ensure utmost quality in the premium raw materials selected, in the state-of-the-art production and distribution processes applied and in the vanguard coffee tasting and retail concepts continually developed to surprise and delight coffee aficionados around the globe. Even marketing and retail personnel stay one step ahead of latest coffee trends by continually updating their coffee knowledge through the specially developed Nespresso Science of Coffee Program, a comprehensive coffee training program developed and run internally to ensure the high level of coffee expertise of Nespresso staff.

**Nespresso Coffee Sommelier™ Program with the Nespresso Coffee Codex at its heart**

Nespresso, as the pioneer who has revolutionised the coffee experience for millions of consumers, recognises the changing role of the professionals in food and beverage services. Specifically, today’s sommeliers share in their clients’ passion and expertise for highest quality coffee.

Consequently, Nespresso has developed a unique educational program exclusively designed for world renowned chefs and professional sommeliers: the Nespresso Coffee Sommelier™ Program, based on the Nespresso Coffee Codex. Since the Nespresso Coffee Sommelier™ Program was launched at the beginning of 2009, more than 50 sommeliers from renowned Michelin star restaurants in 15 countries have been introduced to the world of Grand Cru coffees.

Today's consumers are ever more sophisticated in their knowledge and experience with fine dining. With the growing sophistication and attention of this clientele, professionals in the world’s leading restaurants are facing ever more detailed questions about the foods and drinks they serve.

The Nespresso Coffee Codex is a unique methodology developed for professionals by Nespresso coffee experts and some of the world’s leading wine experts. The aim is to help professionals in leading restaurants in the delicate task of tasting and pairing premium coffee with a variety of fine foods and beverages. This program enables sommeliers to create new gastronomic experiences for today's consumers.

Premium coffee, like fine wine, enriches a meal with sensations that leave a lasting impression well beyond exiting the restaurant door. In the world’s finest restaurants and cafes, professional sommeliers play a key role in educating their guests about fine coffee. They also play an important part in achieving harmonies of perceptions, as well as
matching flavours and aromas to turn a fleeting moment into an
unforgettable dining experience for the guests.

For full details, see annex B: The Full Range of Perfectly Portioned,
Highest Quality Grand Cru Coffees

An unstoppable drive for innovation, distinctive design and R&D
talent responsibility

Continuous innovation and our passion for perfection have been key
drivers of highest quality and growth at Nespresso from the very
beginning. Innovation takes many forms, though often we focus on the
technical aspects. While the evolution of our system has been one
obvious example of innovation at Nespresso, there are many other
elements of innovation and highest quality. Key stages of Nespresso
growth are punctuated with important innovations across our Trilogy of
highest quality coffee, smart and stylish machines, as well as
unmatched personal services.

The Nespresso in-house Research and Development Team combines
attention to detail and cutting edge technology to drive the on-going
innovation of the Nespresso System – the specific interaction of the
original Nespresso capsule and machine. Genuine Nespresso capsules
deliver the coffee quality our Club Members enjoy and expect. Working
in close collaboration with an external design partner and a select
number of machine partners, the Nespresso R&D Team has pioneered
many award-winning innovations and cutting-edge designs. These
breakthroughs have been granted more than 1,700 patents.

A global brand community with privileged direct customer
relationships

Nespresso Club Members and customers appreciate the brand not only
because of the exceptional coffee it produces, but also because they
value its innovative spirit and its focus on highest quality and style.
These qualities also link Nespresso Club Members who are forming a
global community of coffee connoisseurs who stand as the brand’s
strongest ambassadors. In fact, much of the success Nespresso has
enjoyed in recent years can be attributed to the privileged relationship
the brand has developed with its consumers and the reciprocal
enthusiasm consumers have consistently shown for the brand.
Currently, more than 50% of all new Nespresso Club Members first
experience the brand through existing Members. Since 2000, the
number of Nespresso Club Members worldwide has jumped from
600,000 to over seven million.

An inspirational, iconic global Brand

Behind the prestigious marquee of Nespresso lies a personality like no
other. It’s selective, yet inviting; accomplished, yet still inspiring; simple
and refined. It offers timeless quality and perfection with a touch of
luxury – while constantly striving to shape the future. Not content to follow trends created by others, Nespresso is continually infusing itself with original ideas, flavours and innovations from around the world to define its own unique lifestyle. Its fascinating journey towards becoming an iconic brand has made it a well recognized, loved and respected reference for highest quality around the world.

Exclusive route-to-market

The unique Nespresso business model allows the brand to maintain direct relationships with its customers. Consumers worldwide can select to interact with the brand through a choice of channels.

- The Nespresso e-commerce platform (www.nespresso.com) allows consumers to tap into the world of Nespresso. It provides a 24-hour ordering system for coffees, machines and accessories in seven different languages. Consumers can also access information on coffee countries of origin, coffee varieties, recipes and exclusive opportunities for Club Members to participate in special events. This platform is the leading channel for the brand, accounting for around 50% of company sales.

- A global retail boutique network allows consumers to experience the brand with all senses. Nespresso Boutiques provide a window into the heart of the brand and also serve as a key sales outlet, generating approximately around 30% of the company’s sales. Many boutiques include an area where coffee enthusiasts can savour and learn about premium coffee quality. Nespresso Boutiques incorporate a gallery of coffee machines so that consumers can choose the model best suited to their lifestyles. Each location showcases collections of accessories and coffee preparation ideas to enable consumers to re-create their own ultimate coffee experiences at home.

- Customer Relationship Centres provide consumers another means to easily connect with Nespresso. Their needs can be met on the phone by a friendly, knowledgeable coffee specialist who provides advice on coffees and machines and instantaneous ordering of Nespresso products. Customer Relationship Centres are important in maintaining customer loyalty and are responsible for around 20% of Nespresso sales.

Expertise and Commitment to Sustainable Development

Nespresso is committed to ensuring sustainability throughout its operations. Nestlé’s unique sustainability framework “Creating Shared
Value” provided the platform for the Nespresso sustainability programme. In 2003 Nespresso launched its AAA Sustainable Quality™ Coffee Program, a groundbreaking partnership with the leading environmental NGO Rainforest Alliance. Through the AAA Program, Nespresso is committed to ensuring highest quality and sustainability in its coffee supply chain, whilst helping to improve the standard of living for farmers and their families.

In 2009, Nespresso took its commitment to sustainability to the next level, by announcing Ecolaboration™. This consolidates and extends all Nespresso sustainability efforts in coffee, capsules, machines and its overall operations into one concerted program which will provide a framework for partnership and innovation to drive ongoing, sustainable innovation.

At Nespresso, Ecolaboration™ will deliver:

• a platform for partnership with business partners, stakeholders and innovators who contribute to the continuous improvement of the sustainability of the Nespresso value chain.

• a networking framework to bring together key stakeholders, thinkers, advisors, technical experts, NGOs, business partners and others to collaborate around new ideas and innovation, which will serve to improve the sustainability performance of Nespresso. Further specific Ecolaboration™ commitments and framework agreements between Nespresso and its key partners.

In launching Ecolaboration™, a platform for sustainable innovation, Nespresso is committing itself to three major targets that will significantly enhance its sustainability performance by 2013. These commitments are to:

• source 80% of its coffee through its unique AAA Sustainable Quality™ Program and Rainforest Alliance Certified™ farms by 2013.

• put systems in place to triple its capacity to recycle used capsules to 75% by 2013.

• reduce the overall Carbon Footprint required to produce every cup of Nespresso by 20% by 2013.

Richard Girardot, CEO of Nestlé Nespresso SA said:

“For some time, Nespresso has been a highly successful company and strongly active in sustainability. Today, we are announcing Ecolaboration™ and its ambitious targets, which will be our path to truly sustainable success in the future. By introducing sustainability based innovation in sourcing our coffee, build on our track record of

Innovation and Value: The Nespresso Case 41
encouraging and facilitating our Club Members to recycle aluminium capsules, reducing the carbon footprint of our machines and our overall operations, Nespresso will continue to meet the high expectations of our Club Members and NGO partners into the future.”

In addition to providing a framework for Ecolaboration™ agreements, the program will foster best practice and creativity through unique collaborations under two new initiatives:

• The AluCycle™ initiative has the objective of promoting enhanced sustainability performance of aluminium. In June 2009, Nespresso partnered with IUCN – the International Union for Conservation of Nature – to convene an industry roundtable on improving the sustainability performance of the aluminium used for Nespresso capsules.

• The VerTech™ Network brings together Nespresso machine suppliers, engineers and sustainable technology experts to design the Nespresso machines of the future.

From mid 2009 eco timers and stand-by switches will be incorporated into all Nespresso machines to reduce energy use and lower carbon footprints.

As a framework for collaboration and innovation, Ecolaboration™ will also provide the means to work more closely with Nespresso’s key partners, international organizations and NGOs such as the International Finance Corporation, and Technoserve, as well as in-country programs like Costa Rica’s Peace with Nature.

2010: Winning Formula Continues

In 2010, Nespresso was on track to deliver double-digit growth and pass the CHF 3 billion sales milestone. To drive that growth, Nespresso focus on its core competences: its unsurpassed coffee quality and deep coffee expertise, its constant drive for innovation and distinctive design using its in-house R&D expertise, as well as its global brand community built on direct consumer relationships and exclusive customer services.

To meet the expected on-going consumer demand, Nespresso in 2010 continue to investment in growth. Nespresso began to expand its Production and Distribution Centre in Avenches (Switzerland), which came on line in 2009. This next phase is set to complete in 2012. This state-of-the-art, sustainable facility will nearly double its production capacity in the next three years. This expansion will bring the total Nespresso investment in Avenches to about CHF 500 million on completion.
Nespresso continue to make substantial strategic investment in our highest quality Swiss production capability to underwrite its planned future growth. The company’s core competencies enables it continue building demand for Nespresso globally. Its success enables the company to invest to meet that demand.

The company continue to aim at exceeding the expectations of its consumers and enhance their enthusiasm by offering them the highest-quality coffee combined with maximum convenience. As one example, Nespresso combine its in-house research and development expertise with its distinctive design capabilities to offer consumers the most compact Nespresso machine yet. It will show how the Nespresso System – the unique combination of the original Nespresso aluminium capsule and the extraction and brewing unit – will keep pace with developments in state-of-the-art technology, delivering the ultimate coffee experience to consumers wherever they are.

In 2010, Nespresso expand its global retail network, adding more than 30 locations with flagship boutiques in cities such as Brussels, Munich, Miami, New York (Soho). The Nespresso will also be expanding to new geographies such as Shanghai (China), as well as Cape Town and Johannesburg (South Africa) – the first Nespresso locations in Sub-Saharan Africa.

Complementing the continuing boutique expansion, during 2010 Nespresso take its consumers to the next level of brand experience designed to deliver greater satisfaction, personalisation and delight across every Club Member interaction.

In 2010, Nespresso tolled out a new customer service model, starting by renewing the sensory and brand experience in our boutiques. The company will then extend its boutique team’s passion to serve and share to its Customer Relationship Centres and match it with a dynamic new e-commerce platform. This will renovate all three Nespresso distribution channels and consumer contact points.

**2010: Nespresso opens its 200th worldwide boutique**

Located in the popular Grand Gateway Mall in the shopping area of the Xujiahui district, the Shanghai location joins other new Nespresso boutiques opened this year in the international cities of Miami in the United States, Cape Town in South Africa and a flagship boutique in Brussels, Belgium.

Richard Girardot, CEO of Nestlé Nespresso S.A. spoke to journalists at the opening and said:

“Shanghai is China’s gateway to the world and the world’s gateway to China. As the World Expo highlights, this dynamic and cultured metropolis is a great showcase for Nespresso. The opening of our 200th
boutique worldwide and our third boutique in China marks a significant milestone in growing our global brand community”.

A few hours before the Shanghai boutique opened, Nestlé S.A. announced strong first six months for Nestlé Nespresso, with organic growth above 25%. Mr Girardot added:

“Nespresso is firmly on track to surpass CHF 3 billion in annual global sales. Our global boutique network generates around 30% of our sales, showing the important role boutiques play in our Company’s continuing growth”.

Despite a changing competitive environment, Nespresso continues its expansion into new markets and continues with double-digit growth rates in its more established markets, such as Switzerland and France.

In addition, in response to growing consumer demand worldwide, the extension has started in the Nespresso Production and Distribution Centre in Avenches in Switzerland as previously planned. It will double capacity by 2012 and bring total investment there to more than CHF 400 million.

With its 4,500-strong worldwide team, Nespresso delivers strong leadership and continuous innovation in the premium portioned coffee sector. Nespresso opened its first boutique in Paris in 2000. A decade later, Nespresso’s steady global expansion will also take it to Melbourne in Australia, New York (Soho) in the United States and a new flagship boutique in Munich in Germany – all at 2010.
2011: a 3.5 billion Swiss francs brand

Nestle SA's Nespresso capsule coffee brand achieved sales of more than 3.5 billion Swiss francs ($3.82 billion) in 2011, a 20% increase from 2010. Richard Girardot, chief executive of Nestle Nespresso, said:

"Last year, consumers seeking moments of pleasure continued to choose Nespresso despite the turbulent times in many markets and despite a profusion of consumer options in the portioned coffee sector"

Nespresso is one of Nestle's most profitable brands, with profit margins estimated to be around 30%.

Nespresso is the company's strongest area for eCommerce. Nestlé's introduced online sales for Nespresso in the 1990s. Around 50 per cent of its sales coming from the Internet.

Unlocking a Captive Market: The Battle to Unseat the Nespresso

Coffee that comes in capsules has won over consumers in half of the world -- and not just because appealing actor George Clooney is a leading face of the advertising campaigns of Nespresso, the top company in the sector. What is the secret of success for this unconventional way of consuming coffee? "Nowadays, consumers go out less often; and when they remain at home, Nespresso gives them a very good coffee experience without having to go out on to the street," says Vicent Termote, general manager of Nestlé Nespresso, a subsidiary of Nestlé, the Swiss multinational.

Whatever the reasons, Nespresso has managed to dominate the world market for this product since it was created 25 years ago. 2010, 2.5 billion euros of sales were recorded around the world, a 20% increase from 2009. Nespresso's pioneering strategy involved establishing a marriage between the design of the coffee machines and the capsules that the devices used. From the moment the consumer purchased the appliance, his or her relationship with the provider of the coffee was sealed because the machine was not compatible with capsules from other players that later moved into this product category, such as U.S.-based Sara Lee and Italy's Lavazza.

Ignacio Gafo, a marketing professor at IE Business School in Spain, compares Nestlé's closed system for coffee to the business model of tech giant Apple. Both companies created the aura of a premium brand, an attractive, futuristic design for their appliances and marketed accessories (or, in Nestlé's case, capsules) through exclusive boutiques and on the Internet. "The difference is that when you work with technology, it is much simpler to maintain a closed eco-system because you can create technology patents," Gafo notes. "With coffee, when there is a problem with patents, the entire model can collapse."
Such a scenario could be on the horizon for Nestlé. Other leading coffee makers have decided to join the fiesta by selling their own one-cup capsules that are compatible with the Nespresso machine. More specifically, Sara Lee, which owns Senseo-branded coffee makers and Marcilla capsules, recently sold six million of its capsules in Spain. Previously, the company enjoyed similar success in unveiling its Nespresso-compatible capsules in France in 2010 and in the Netherlands earlier this year.

Spain is a tempting market for Sara Lee, since it is the third-largest in terms of sales volume for Nespresso, behind only Switzerland and France. The country also has the largest number of Nespresso retail shops in the world, a total of 28. The Spanish market also has a great deal of room for growth: Although precise figures have not been revealed, the penetration rate of capsules in the Spanish coffee market is an estimated 15% of all homes, which is far below the 50% rate in such countries such as the Netherlands and France.

Nestlé has responded to the competition with a legal battle regarding supposed violations of its patents and intellectual propriety. The Swiss company's system is protected by 1,700 patents. Nestlé's lawsuits against Sara Lee in France and the Netherlands have yet to be resolved. In Spain, Nestlé has yet to make a move against Sara Lee on the legal front, but experts anticipate that the company will take a similar defensive strategy.

Indeed, over the past two years, Ne-Cap, a small Malaga-based company, has been manufacturing and marketing empty versions of these types of capsules. That way, they argue, they are not violating any Nestlé patents. But the Swiss company doesn't agree, and they have sued the Spanish firm. Meanwhile, sources at Union Tostadora, a subsidiary of United Coffee, the largest maker of roasted coffee for European third parties, have told the local media that United Coffee's legal team is studying the possibility of making capsules that are compatible with the Nespresso system.

While waiting to see what happens with pending legal cases, a Swiss judge dealt a blow to Nestlé by lifting a preliminary injunction against Denner, a distribution firm that had launched the marketing of capsules that are compatible with the Nespresso system, but cost around half as much.

**Nestlé vs. Sara Lee**

Experts say Nestlé and Sara Lee, the two largest coffee companies in the world, are likely to duke it out for leadership in this category. Who will emerge the victor depends on Sara Lee's strategy for breaking into new markets with its Nespresso machine-compatible capsules.
"We'll have to see if there have been any patent violations, which is quite arguable because there seems to be an extremely simple mechanism ... for the capsules," Gafo notes. "At first glance, this seems to have less legal support." While the judicial process is going on, "the judge could impose precautionary measures, and get [Sara Lee subsidiary Marcilla] to stop marketing the capsules until [the court decides whether Marcilla] has the right to produce them," Gafo adds. "Although things may turn out badly, Nestlé could win some time and give the third-party producer a bad reputation because of the alleged patent violation."

According to Mario Sol Muntañola, a law professor at ESADE in Spain, Sara Lee should have carefully researched what aspects of the Nespresso system are protected by Nestlé's patents.

"Sara Lee should have investigated the patent registry to see if Nestlé had patents and if they were still valid and what they were. It should have looked into whether Nestlé had the royalties and how the company distributed its products in the market."

For example, notes Sol, instead of using a rectangular box with capsules stored in a straight line, as Nestlé does, Sara Lee's Marcilla could have adopted a package in which various kinds of capsules are mixed together, using different names from those used by the Swiss company. Marcilla could have also distributed the capsules in supermarkets, rather than Nespresso-style boutiques. Such moves would have differentiated the company within the competitive marketplace, so they would not collide with Nespresso, Sol says. "That way, it would be very hard for Nestlé to take legal action against Marcilla."

Sol compared the current battle between Nestlé and Marcilla to competition that often springs up between the manufacturers of ink cartridges for printers.

"Manufacturers make very complicated cartridges that work with exclusive machines, and by protecting the cartridges, they protect the market."

In Sol's view, Nestlé must protect its brand; the design of its capsules (the exterior configuration of the product); its patents, and its way of operating in the market through specialized boutiques. If other companies are able to legally bring Nespresso machine-compatible capsules into the market, then the Swiss company may have to "go back and patent a product in such a way that it is exclusive again. What the market doesn't want to have is permanent monopolies and captive markets."

**A Premium Experience**

Meanwhile, coffee capsules compatible with the Nespresso machine that are being sold by Marcilla under the name "L'Arome Espresso"
have broken sales records in Spain's supermarkets. Already, 10 million capsules have been ordered. Gafo notes that, with this development, Marcilla can not only generate financial losses for Nestlé, but it can also change the consumption habits of customers. Today, Nespresso is sold in more than 50 countries.

According to Gafo, Nestlé could face a scenario quite similar to the challenge facing makers of printers that use device-specific ink cartridges: Consumers could confuse their experience with the cartridges with the performance of the machines that use them:

“If a user buys the cartridge of an alternative company and it functions poorly, or they don't get the same quality, consumers don't stop to think about who is responsible; they immediately assume that the problem is the machine. If there is a bad experience because the capsule doesn't meet their needs, it is Nestlé that has the problem, not Marcilla. So Nestlé has everything to lose.”

On the other hand, if it turns out that the Marcilla capsules are better, consumers will think that Nestlé has a better team, since Marcilla has a superior consumer product. Gafo warns that the risk exists that, quite suddenly, a migration to the new capsules could take place. Nevertheless, Nestlé has an ace up its sleeve, and it has nothing to do with its strategy of using legal means of defense:

"Nespresso provides a relatively premium product at a price that is relatively affordable." Gafo cannot imagine eating at a friend's home and seeing that "they bring out a Nespresso machine for you, along with the cartridges from some 'off brand'. This is not part of the Nespresso purchasing experience, which is always unique and always uses both the machine and the cartridges."

For all that, Gafo believes that the possibility exists that people will try capsules from an outside provider, which could damage the experience and premium aura surrounding the Nespresso brand. To counteract this challenge, Gafo advises Nespresso to inject a greater amount of innovation into its business strategy. So far, the company's innovations have been largely limited to its business model, to the wide variety of coffee flavors that it offers, and its skill at customer relationship management. However, “At times like this, if they had a very fluid relationship with their entire line-up of customers, they would be in a much more protected position that they are now."

Finally, Gafo believes that, as much as possible, Nespresso will have to leverage the strong positioning of its brand “to incentivize its customers, through its advertising campaigns, to use the original Nespresso-made capsules.”
Conclusion

More than 25 years after Nespresso's a couple of questions preoccupied those who were familiar with Nespresso:

1) What lessons could be learned about innovation from the Nespresso story?

2) What must Nespresso do now to maintain its ambitious growth targets?
Exhibit 1
Qualities and Characteristics of a Nestlé Manager

The higher the level of the position and the responsibility of a Nestlé manager, the more he/she should be selected on the basis of the following criteria (in addition to professional education, skills, and practical experience):

- Courage, solid nerves and composure; capacity to handle stress.
- Ability to learn, open-mindedness and perceptiveness.
- Ability to communicate, to motivate and to develop people.
- Ability to create a climate of innovation.
- Thinking in context.
- Credibility: in other words "practise what you preach."
- Willingness to accept change and ability to manage change.
- International experience and understanding of other cultures.

In addition: broad interests, a good general education, responsible attitude and behaviour and sound health.

Source: The Basic Nestlé Management and Leadership Principles
Exhibit 2
The Nespresso System

Source: Company information
Exhibit 3a
Available Varieties of Nespresso Coffee Capsules

Ristretto
Composed of pure Arabica beans from Latin America for its finesse and a touch of Robusta for its intensity, it is savoured very short in a demitasse filled halfway.

Arpeggio
The Grand Crus of Central America give strength and fullness to its aroma while a touch of Brazilian Santos harmoniously balances its flavour.

Roma
A blend of Latin American Arabica for delicacy, this gives the strong, intense espresso of Italian "baristas" with a thick, rich cream. It is the ideal base for making a cappuccino.

Capriccio
A satisfyingly smooth espresso made from early Latin American Arabicas for a rich and straightforward taste, Brazilian Santos for full and consistent body, and a touch of Central African Robusta for intensity. Top with whipped cream for a true Viennese.

Livanto
Made from the best Arabicas of South and Central America, this espresso is rich, intense, and smooth. Savoured in a demitasse or cappuccino cup, with or without milk, it is the morning espresso par excellence.

Cosi
A pure Arabica with all the fullness and flavour of the Grand Crus of Central America, the density of mountain grown coffees from Eastern Africa, and a touch of mildness from Brazilian Santos. With milk, this espresso can be savoured as a cappuccino.

Volluto
A delicate yet full-bodied pure Arabica espresso. The mellow richness of early Latin American beans gives this blend a distinct, elegant, subtle bouquet. Characterised by its mildness, it is ideal any time of the day.

Decaffeinato
Naturally decaffeinated, it has a delicate, balanced, and enticing flavour. Its freshness and intensity come from the great early Arabicas of Central America reinforced by a touch of Central African Robusta.

Source: Promotional material provided to Nespresso Club members
Exhibit 3b
Available Varieties of Nespresso Coffee Capsules

Exhibit 4
Growth of Nestlé Coffee Specialties
Turnover, Employees, and Nespresso Club Members
1989-1999

Source: "Nespresso Prodige”. Bilan, April 1998, and company information
Exhibit 5
Development of NCS Capsule Sales
1990-1999

Source: Company information
Exhibit 6
Impressive Sales Development
1990-2008

Impressive Sales Development

- Turnover doubled with in 2 years
- Today, Nespresso sells 10x more than in 2000
- Average annual growth rate exceeds 30% over the last 8 years

(In million CHF)


Exhibit 7
Nespresso Business Model

SOURCE: http://www.businessmodelgeneration.com/
Exhibit 8
Nespresso History

**Pioneering years: trial & error**

Nespresso, a company wholly owned by Nestlé S.A., introduces its first machines and launches the first four Grand Cru varieties.

**1986**
- **COMPANY**: Nespresso S.A., a Nestlé Group company, is founded. Inspired by Luigi Bezzera’s original espresso coffee concept, it devotes itself to creating a range of machines and coffee and decaffeinated machines that rival the delivery of perfect coffee.
- **SYSTEM**: Nespresso’s initial coffee varieties include Capsico, Costa, Penta Rota, and Bonini (now known as Viso). The first coffee machines offered (the C-100) and C-100S) are designed to resemble miniature espresso machines.
- **MARKETS**: The range is first sold and launched in the office coffee sector in Switzerland, Japan, and Italy.

**1989**
- **MARKETS**: The system is introduced in the Swiss household market with Turina six-machine partners.
- **SERVICE**: The Nespresso Club is created to offer a range of exclusive and personalized customer services. It becomes the definitive feature of the Nespresso brand.
- **Nespresso consumer impulse is produced with a member-get-member offer. Growth at this stage is entirely consumer driven.

**1991**
- **COMPANY**: The first Nespresso capsules recycling program is introduced in Switzerland with 24 collection points.
- **MACHINES**: While Nespresso develops its own machines, Bugatti becomes its exclusive machine partner.
- **MARKETS**: Nespresso is introduced in the household sector in France and the United States to mark the first major expansion.
- **BRAND**: Direct-to-consumer marketing employing Nespresso as the ultimate coffee experience plays a key role in improving the brand’s development.

**1992**
- **SERVICE**: Chocolate squares are introduced as an incentive.

**1993**
- **COMPANY**: Paco Tancrède becomes CEO of Nespresso, becoming the first coffee company executive to head a coffee company.

**Start-up phase: laying the foundation**

Innovation and investment power growth and integrate Nespresso to finance time-wise. The Nespresso in scale as few markets are opened. New markets are developed and the Grand Cru coffee range continues to expand. The first e-commerce platform allows 24/7 online ordering.

**1986**
- **COMPANY**: Nespresso matches biệtéoumien.
- **MACHINES**: Manufactured by Amour, the first automatic Nespresso machine is released on Switzerland after three years for the international coffee market.

**1986**
- **SERVICE**: The first Internet site offers a platform to promote Nespresso coffee expertise and stimulate its policies develop into a key brand experience and sales channel.
- **MACHINES**: The C240/344 machine with automatic dosing and a new thermoblock is launched as a new wave of the new FAMILY range of machines is released on November 30th.

**1987**
- **MARKETS**: As a part of a new multi-brand strategy, new Nespresso machines are introduced, including the C240, C344, and C444, designed for professionals and the home user, and marketed in the United States.
- **COMPANY**: stools, the eight Nespresso coffee machines are launched.

**1988**
- **COMPANY**: The corporate name becomes Nespresso S.A.

**1990**
- **Nespresso Professional**, a new line of professional machines designed for small businesses and the premium foodservice sector.

**1995**
- **MACHINES**: A new system is launched featuring Nespresso Professional, with decaffeinated machines and coffee extracts packaged in pods designed for small businesses and the premium foodservice sector.
Creating an iconic global brand

Nespresso growth is based on a continuous innovation and personalization that elevates the experience of coffee drinking, and starts the journey towards becoming an iconic global brand.

2001
COFFEE:  The company launches its first United Coffee & Gift Café in Italy.

2002
COFFEE:  A new Nespresso Production Centre starts up in Colle, Switzerland, expanding capsule production capacity by 45 per cent.

2003
COFFEE:  Designed to promote production and quality of unique and highest-quality coffee, the Nespresso Production Centre in Colle, Switzerland is inaugurated.

2004
MACHERES:  Nespresso launches a new coffee range, together with new retail and coffee specialty visions, as introduced.

2005
SERVICE:  A new Nespresso Boutique is inaugurated in New York City, and in 2006 is extended to New York City and beyond.

Shaping the global coffee culture
Nespresso achieves double-digit growth rate and confirms the brand’s success. The company focuses on highest quality coffee, continuous innovation and personalized services to create an innovative coffee culture around the world.

2006
COMPANY:  Nestle Nespresso SA exceeds CHF 1 billion in revenue for the first time.
BRAND:  Nespresso becomes the global leading brand ambassador and star in a film of a series of celebrity publicity campaigns.
MACHINES:  The Le Barron coffee machine sets new standards in coffee, with its minimalistic and double shape.
COFFEE:  An innovative range of flavoured coffees is introduced as a year-end offer.

2007
MACHINES:  The new Linea machine is introduced with new technology that will assist in the preparation of fresh milk specialty coffee drinks.

2008
COMPANY:  A new state-of-the-art Nespresso Production & Distribution Centre is inaugurated in Avenches, Switzerland, to meet rapidly expanding demand.
COFFEE:  Sustainability efforts are a cornerstone of Nespresso’s sustainability strategy.
COFFEE:  A permanent range of biodegradable capsules is introduced with the introduction of three pure organic coffees and four new Lungo drinks. The new Coffee Caddy and Coffee Softpillows™ program underlines Nespresso coffee expertise.

2009
COMPANY:  A new state-of-the-art Nespresso Production & Distribution Centre is inaugurated in Avenches, Switzerland, to meet rapidly expanding demand.
COFFEE:  The permanent range of Nespresso coffee is renewed with the introduction of three pure organic coffees and four new Lungo drinks. The new Coffee Caddy and Coffee Softpillows™ program underlines Nespresso coffee expertise.

2010
SERVICE:  A new boutique concept is launched in Munich, Germany, being innovative customer service tailored to customer preferences.

2011
MACHINES:  Nespresso launches its first ‘One Touch’ machines during the year FINE. As most innovative and ecological machine ever, Zenero One Touch has been designed to enhance functionalities to professional consumers.

Les Chocolats

Nespresso AAA Sustainable Quality™ Program

Cup2

Nespresso boutique in Munich, Germany
Exhibit 9
The Nespresso market tripled share in 10 years (1995-2005)

Exhibit 10
The Nespresso Benefit Pyramid

5 Key Competitive Advantages

- Best In-Cup Quality
- Variety/Choice
- Optimum Convenience
- Smart machines
- Best Service
Exhibit 11
Boutiques complete role

Exhibit 11
The Nespresso Collection
Exhibit 12
Internet: 1998-2005

Exhibit 13
Nespresso boutiques and coffee bar
Exhibit 14
Nespresso business model canvas
(http://www.businessmodelgeneration.com/canvas)
APPENDIX
The World Coffee Market: Mature and Highly Competitive

Globally, the Coffee market was in a mature stage. Growth had been achieved only through increased retail prices and growing consumer demand for high quality, gourmet coffee (refer to Table 1). European countries led the world in per capita coffee consumption, with Scandinavian nations heading the list (refer to Table 2). The Coffee market was split between R&G coffee and instant coffee, and secondarily between the "away-from-home" and "inhome" sectors (refer to Tables 3 and 4). Worldwide, R&G accounted for almost 70% of coffee sales or about US$198 billion at average consumer retail price, whereas instant coffee accounted for 30% of sales or US$85 billion (refer to Table 5).

The Coffee industry was dominated by food multinationals renowned for their strong brands, aggressive pricing, and high marketing expenditures. Nestlé was actually the world's largest coffee company with a 23% share of the total market (refer to Table 6). The company dominated the instant coffee segment with a 56% share from its flagship brand, Nescafé, and its numerous product varieties, but the company was ranked fourth in the R&G segment with a 7% share. Philip Morris (Kraft Jacobs Suchard, Maxwell House), whose food business generated over US$27 billion, was the second largest coffee company with a 14% share of the total market. The company was the leader in the R&G segment with a 13% share and second in instant coffee. Sara Lee (Douwe Egberts), with an annual turnover of US$20 billion, was the third largest coffee company with a 7% share of the total market. It was the second largest player in the R&G segment. Procter & Gamble (Folgers Coffee), with an annual turnover of US$37 billion, was the fourth largest coffee company with a 6% share of the total Coffee market.

In recent years, profit margins for Coffee producers had been narrowing as a result of growing competition in the R&G segment. This trend had encouraged companies to enter the smaller, but higher-margin, high growth gourmet coffee segment. In 1999, this segment was estimated to be worth US$ 10 billion world-wide and was growing at a rate of 20%.
Table 1
Total World-Wide Coffee Consumption in billions of cups: 1980-1996 (all Coffee, all channels)

![Bar chart showing total world-wide coffee consumption by region from 1980 to 1996.]

Source: Company information

Table 2
The Leading World Markets for Coffee Consumption per capita consumption in total cups, 1996

<table>
<thead>
<tr>
<th>Country</th>
<th>Consumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finland</td>
<td>1,495</td>
</tr>
<tr>
<td>Sweden</td>
<td>1,132</td>
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<tr>
<td>Netherlands</td>
<td>1,105</td>
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<tr>
<td>Norway</td>
<td>1,094</td>
</tr>
<tr>
<td>Denmark</td>
<td>1,064</td>
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<tr>
<td>Switzerland</td>
<td>902</td>
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<tr>
<td>Austria</td>
<td>871</td>
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<tr>
<td>Costa Rica</td>
<td>777</td>
</tr>
<tr>
<td>Germany</td>
<td>756</td>
</tr>
<tr>
<td>France</td>
<td>745</td>
</tr>
<tr>
<td>Belgium/Luxembourg</td>
<td>719</td>
</tr>
</tbody>
</table>

Source: Company information
Table 3
Market Breakdown by Country R&G vs Instant Coffee
1995
Innovation and Value: The Nespresso Case
Table 4
"Away-from-Home" vs "In-Home"
R&G and Instant Coffee
(world-wide consumption in billions of cups: 1996)

Source: Company information

Table 5
Partial Structure of the Global Coffee Market, 1999

Source: International Coffee Organisation and company information
Table 6
World’s Leading Coffee Roasters
Market Share by Volume, 1995

Source: International Coffee Organisation, Encyclopaedia of Global Industries, (Food, Drink, and Tobacco Products), and company information