

[español](#)[português](#)

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

 Printer Friendly Version


wiss multinational.

Whatever the reasons, Nespresso has managed to dominate the world market for this product since it was created 25 years ago. Last year, 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, 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.

[Finance and Investment](#)[Leadership and Change](#)[Executive Education](#)[Marketing](#)[Insurance and Pensions](#)[Health Economics](#)[Strategic Management](#)[Real Estate](#)[Public Policy and Management](#)[Human Resources](#)[Business Ethics](#)[Innovation and Entrepreneurship](#)[Operations Management](#)[Managing Technology](#)

¿quiere ser patrocinador?

FORMACIÓN, INFORMACIÓN Y
SERVICIOS ON-LINE PARA EMPRESAS

 Santander

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, 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'Arôme 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." In the case of coffee, Gafo says, "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."

Publish Date: Jun 01, 2011

Enlaces

[Beware of Dissatisfied Consumers: They Like to Blab](#)

[The Coffee Wars Heat Up: New Strategies to Jolt the Caffeine-Conscious Consumer](#)

[Getting Close to the Customer: Quantitative vs. Qualitative Approaches](#)



printer friendly
version

[buscar](#) | [suscripción](#) | [quiénes somos](#) | [ayuda](#) | [inicio](#) | [contactar](#) | [patrocinadores](#)

El copyright de todos los materiales es propiedad de la [Wharton School](#) de la [Universidad de Pennsylvania](#) y [Universia](#). [Política de Privacidad](#)