

# Shanghai University of Finance and Economics

## 2017 24H BUSINESS CASE STUDY

Limited time & limitless possibility

主办单位  
上海财经大学会计学院

案例提供方  
澳洲会计师公会



协办单位（排名不分先后）（初拟）



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华东师范大学、江西财经大学、立信会计学院、  
南京审计大学、宁波诺丁汉大学、南京邮电大学、  
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# 1 The Australian coffee manufacturing industry

## A About the industry

### Background

Coffee beans were brought to Australia by the First Fleet in 1788 with the intention of growing coffee in the colony. However, growing conditions were not suitable, resulting in the continued importation of coffee. The arrival of migrants in the Gold Rush era in the 1890s was a major catalyst in growing the demand for, and supply of coffee.

The history of instant coffee began during World War II when it was provided to American soldiers. Instant coffee gained popularity in America through the 1950s. The increase in international travel saw instant coffee spread to Australia.

The popularity of the café style espresso that is prevalent in Australia today began with the invention of the coffee machine by Achille Gaggia, an Italian café owner. The Gaggia machine heated and pressurized water and filtered it through ground coffee beans, creating the espresso coffee. There has been wide debate as to when the first Gaggia machine was introduced into Australia, however, it is generally agreed that four machines were imported into the inner suburbs of Melbourne around 1954. Embraced and championed by a generation of Italian migrants, espresso coffee gained popularity and has since been the preferred taste for higher-quality coffee for many in Australia.

Coffee is now the second most preferred beverage behind water.

### Industry definition

Coffee manufacturers purchase green coffee beans (as raw materials) and process them into various types of coffee products that are sold to a range of customers, including other manufacturers, retailers and food distributors.

### Industry performance

The industry has consistently demonstrated high resilience and continued growth, despite impediments such as the Global Financial Crisis (GFC) and volatile commodity prices.

Coffee is now considered a staple household good and consumption has proven to be largely resistant to changes in economic conditions. During times of economic uncertainty, consumers often economize on expensive aspects of their household spending, however, recent data from Ibis World (2015) suggests that not only has coffee consumption remained stable, but consumers are seeking more sophisticated and premium-priced products.

It is estimated that in 2014-2015, Australian coffee manufacturers will generate revenue of AUD1.3 billion, with growth in coffee consumption mainly occurring through café visitations and ownership of home coffee-making

machines.

Euro monitor International's (Euro monitor) report on coffee consumption in Australia (2015) states that 97 per cent of the overall growth in purchasing coffee for consumption in the home between 2013 and 2018 will be in the form of roasted ground coffee. Ibis World predicts there will be a continued strong demand for better tasting and higher quality coffee, which is likely to put pressure on supply and prices of premium products.

### **Lifecycle stage**

Coffee is a mature product in a mature market. The industry is characterized by intense rivalry, highly concentrated ownership of brands, low organic growth and well-established products. Sales growth has been driven through product innovation and changing consumer preferences rather than price.

The industry has benefitted from the introduction of new products and technologies. One of these is the coffee capsule system which, according to Ibis World, has 'revolutionized' coffee in the home. Over the last five years, niche and specialized products such as organic and fair trade coffee have also grown the industry.

## **B Industry segmentation in Australia**

The industry has two distinct product segments: roasted (fresh) and instant (soluble). 'Ready-to-drink' coffee is packaged and sold in a prepared form that is ready for immediate consumption and is considered part of the soft drinks industry. It is out of scope for this case study.

### **Roasted coffee**

Roasted coffee is the result of roasting green coffee beans. The freshness of the bean begins to deteriorate once the bean has been roasted so the roasting usually takes place geographically close to the end customer. The product also loses quality through exposure to air, so it is frequently packed in vacuum-sealed packs. Consequently, roasted coffee has a shorter shelf life than instant coffee.

Roasted coffee is sold as;

- Whole beans
- in ground form and ground,
- in capsules.

### *Coffee capsules*

Coffee capsules are small, heat-sealed containers that hold around 4 to 6 grams of roasted ground coffee. The coffee capsules are used by compatible espresso coffee machines, which are produced by specialist appliance

manufacturers. It is known as single-serve coffee because the preparation methods are designed to serve one cup at a time.

### **Instant coffee**

Instant coffee is a soluble form of coffee. There are different quality types of instant coffee:

- **Premium brands of freeze-dried instant (soluble) coffee**  
Freeze-dried instant coffee is gaining market share in the majority of countries at the expense of other types of soluble coffee. It holds 25 per cent of the instant coffee market in Australia. Extra premium brands of freeze-dried coffee are composed solely, or mainly, of Arabica beans<sup>1</sup>.
- **Standard brands of spray-dried instant (soluble) coffee**  
Otherwise known as agglomerated coffee, this is the most popular form of instant coffee. Spray-dried coffee is coffee dried rapidly with a hot gas. Sales of standard brands account for more than half the instant coffee sales in the majority of consumer markets around the world, including Australia, although it is losing market share to freeze-dried instant coffee.
- **Cheap brands of spray-dried instant (soluble) coffee powder**  
This is the cheapest type of instant coffee available and is losing market share to all other types of instant coffee.

Instant coffee is also pre-mixed into packages known as 2-in-1 (instant coffee and creamer), 3-in-1 (instant coffee, sugar and creamer) and 4-in-1 (instant coffee, sugar, creamer and added flavor).

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<sup>1</sup> Arabica beans have a milder, less bitter taste and are considered a premium coffee bean.

## **C Drivers of demand**

### **Demand for premium products**

Australia is the largest market for instant coffee, registering the highest percentage of consumption per capita, of any coffee-drinking country (Euro monitor 2014). However, in-home consumption of instant coffee is starting to decline, dropping from 80 per cent of all coffee purchased from a retailer in 2010, to 75 per cent in 2014.

According to Business Information Services' (BIS) Foodservice's Coffee and Beverages 2012 report series, by 2020 roasted ground coffee is expected to overtake instant coffee as the main hot beverage consumed in Australian homes.

Industry analysts have noted that despite downturns in economic activity over the last five years, the demand for high quality coffee continues to grow. It is considered an 'affordable indulgence'. This is consistent with a practice known as premiumisation – where a product is positioned as premium and the brand marketing activity reinforces this.

### **Growing the 'out-of-home' offering**

Ibis World estimates that more than one billion cups of roasted ground coffee were consumed in Australian cafés, restaurants, and other similar outlets in 2014. This represents an increase of 65 per cent over consumption levels of ten years ago (Ibis World 2015).

The proportion of Australians aged 14 and over visiting cafés in an average three months between 2010 and 2014 rose from 53.7 per cent to 56.8 per cent (Roy Morgan Research 2015). The figures also indicate that Australians prefer independent, 'boutique' cafés and coffee shops over larger, franchise chains (Ibis World 2015).

Coffee shops, cafés and bakeries account for 57 per cent of all out-of-home coffee purchases, with 16 per cent of coffee purchases occurring in Quick Service Restaurant (QSR) outlets which comprise the second biggest segment (Consumer Reports on Eating Share Trends 2014).

Euro monitor predicts that the increase in coffee consumption outside of the home will continue in part due to the increased pace of people's lifestyles.

### **Recreating the café experience**

#### *In the home*

Technological advances and innovation have seen the invention of various types of coffee machines available for in-home use. These include machines that use pressurized water and steam, those that use roasted ground coffee capsules, and those using drip-feed through filters. Ownership of a coffee making machine in the home is increasing, with 36 per cent of Australians aged 18 years and over in 2013 owning one. This is an increase

from 28 per cent in 2009. The biggest movement in Australian coffee consumption is demand for roasted ground coffee capsules, where sales grew nearly ten-fold over the five years to 2013.

Coffee capsules now comprise around half of all roasted ground coffee sales, and sales of coffee capsule machines are demonstrating strong growth, up 22 per cent in 2013 (Euro monitor 2015). Analysts estimate that in Australia, spending on capsules exceeded AUD150 million annually in 2014.

Table 1 shows the increase in expenditure, consumption and the size of the coffee capsule market in Australia from 2008 to 2013 with predictions for 2018 (projected data).

**Table 1**

*Expenditure, consumption and the size of the coffee capsule market in Australia.*

	2008 (Actual)	2013 (Actual)	2018* (Projected)
Amount spent on Capsules Coffee (AUD)	13.4 million	134.1 million	248.3 million
Consumption of Capsule Coffee	144.6 tonnes	1 496.2 tonnes	3 833.2 tonnes
Capsule sales as a percentage of Roasted Coffee Market	11.1 per cent	50.4 per cent	65 per cent

*【Source: Sydney Morning Herald based on Coffee in Australia, Euro monitor 2014 (2018\*- Projected)】*

#### *At work*

The business sector is gaining market share of coffee machine sales in Australia (see Table 2). The business sector includes professional offices and work-related buildings.

**Table 2**

*Sales of coffee machines in the business customer market as a percentage of all coffee machines sold in Australia*

Type of machine	% of sales of coffee machines in the business sector	
	2010	2012
Roasted ground coffee machines	19%	30%
Coffee capsule machines	7%	14%

*【Source: BIS Shrapnel 2012 (Note that more recent data is not available).】*

## **D Current Trends**

### **Convenience**

Convenience of use is one of the main reasons for the rise in the single serve coffee capsule. As people become

busier and consequently time sensitive, there is a preference for appliances and products that reduce preparation and cleaning times. As consumers value their time over money, they are prepared to pay a premium for convenience.

### **Lifestyle trends**

There has been a shift in attitudes and behavior as consumers become more health conscious. The demand for organic and decaffeinated coffee options has encouraged manufacturers to provide alternatives.

### **Global Social and Environmental Awareness**

The rise in awareness of socially responsible industry practices has seen an increase in fair trade practices and enforcement of accreditation standards by organizations such as Rainforest Alliance, UTZ Certified and Fair Trade.

Rainforest Alliance provides economic incentives and support to coffee farmers using more sustainable farming practices to protect rainforests and limit degradation. Practices include water conservation, recycling pulp into fertilizer and paying staff higher wages. A higher price is paid for Rainforest Alliance coffee beans.

UTZ Certified coffee is grown on a farm that has qualified for the UTZ program, originally launched as UTZ Kapeh Foundation, where utzkapeh means 'good coffee' in Quiché, a Mayan language in Guatemala. The UTZ program supports farmers enabling them to be more sustainable and incorporate more efficient farming practices. This provides a better standard of coffee crop which generates higher yields and better incomes for the farmer, their family and the community.

Fair Trade coffee is purchased from suppliers at a price that is set above the prevailing subsistence market price, guaranteeing farmers a 'fair' return for their efforts. According to an Ibis World report in 2015, Fair Trade coffee has had strong growth in the Australian coffee industry over the last five years.

## **E Supply Chain**

The supply chain for the coffee industry is complex for the following reasons:

- There are different types of growers ranging from small to large farms creating different places to source the coffee bean
- The extensive process of preparing the coffee bean for sale to the end consumer
- The different stages within the supply chain at which coffee may be purchased, whether from a cooperative, directly from the farmer, an offshore exporter or from an importer.

Fluctuations in commodity prices, unsustainability of supply, increases in the cost of raw materials for growers, the effects of climate change and the strength and buying power of manufacturers all add volatility to the supply chain.

### **Global supply**

Coffee is grown predominantly in countries located in the equatorial zone due to the suitable growing conditions found there. The practice of coffee growing is characterized by unpredictable volumes, with a large crop one year frequently followed by a smaller yield in the next. Brazil, Vietnam and Columbia all have established coffee bean industries.

Brazil produces one-third of the world's coffee, including about half of the world's Arabica beans which are used in premium blends. Brazil's coffee-growing regions are currently in drought, with rain levels the lowest since the 1930s. As a result, Brazil's production levels are expected to be 12 per cent lower in 2015, following an already low yield in 2014.

Global production has reduced, impacting Arabica coffee bean prices on international commodity markets. The price of Arabica coffee beans spiked in 2014 at USD2.10 per pound, since their peak at USD2.40 per pound in 2012.

In 2014, Colombia, the second biggest grower of Arabica beans, produced its best output in seven years, according to coffee trader, Volcafé.

Vietnam supplies 23 percent of the world's Robustabeans, the lower quality beans mainly used in instant coffee and cheaper blends of roasted ground coffee. Industry analysts anticipate that in the 2015-2016 seasons, Vietnam will produce a record harvest. Industry analysts predict that although Colombia and Vietnam are raising coffee output, shortfalls of supply will continue as the global demand for coffee continues to grow.

As strong growth in coffee consumption continues in Australia, security of supply is not only an issue of growing importance, but is also putting pressure on prices.

Coffee beans are grown on farms, which range in size from very small owner and/or manager to larger plantations. Large coffee plantations often export their own crops or have direct arrangements with international coffee processing or coffee manufacturing companies. According to the Food and Agriculture Organization of the United Nations (FAO), there are nearly 25 million coffee growers globally with around 90 per cent of the world's coffee grown in developing countries. Conversely, consumption is mainly in developed economies.

The Specialty Coffee Association of America (SCAA) estimated that in 2013, independent small farms made up 55 per cent of coffee farmers globally, and small farms joined as cooperatives made up 25 per cent of the

world's coffee suppliers. Larger farms made up the remaining 20 per cent.

Small farms in developing countries have limited or no access to credit, which makes investing in new practices difficult. Coffee growing is very labor intensive, so profit margins are reduced due to wage costs. Further, as small growers, they are exposed to price volatility, which creates uncertain profit levels and limits their ability to plan.

### **Strength of manufacturers**

Blending varieties of coffee beans before roasting improves consistency in the final product. This increases the operational flexibility of coffee manufacturers, as they are less reliant on one source of supply and are better able to respond to problems of price or availability from suppliers. It also allows the manufacturer to compensate for any changes in consumer taste preferences over time.

The buying power of the larger manufacturers distorts the process of negotiating coffee prices and empowers them to dictate terms to suppliers, who are usually the small farmers. The prominence of the Fair trade movement has provided a brand identity, enabling customers to know that products have been procured using the Fair Trade pricing system.

Coffee manufacturing is a capital-intensive process and requires investments in establishment costs, plant and machinery, and technology. Other costs associated with coffee manufacture include costs of inputs, distribution, marketing and research and development.

Larger coffee manufacturers have well-established positions in the industry due to the significant resources available to invest in product innovation, marketing and capital assets. Established coffee manufacturers also have considerable customer loyalty and brand awareness.

The level of capital equipment needed to manufacture coffee, coupled with the other associated costs, is a deterrent to other coffee manufacturers from entering the market. However, due to the increase in the demand for niche coffee products, there are more opportunities for niche coffee manufacturers to enter the industry.

### **Retailers**

#### *Supermarkets and grocery stores*

Due to the oligopolistic nature of the Australian supermarket industry, retail supermarket chains have superior buying power and negotiating strength. This has led to discounting, price wars and the squeezing of industry margins. Consumer preferences and lifestyle changes are influencing the types of coffee products demanded by supermarkets. Ibis World predicts that demand from supermarkets and grocery stores will strengthen in the near term, due to the increase in consumption of coffee at home.

### *Cafés, restaurants and other food service establishments*

Demand is expected to increase as the Australian preference for high quality coffee and new coffee experiences continue to drive industry performance. Coffee shops and cafés generally enjoy healthy profit margins because of relatively low input costs and consumers' willingness to pay a higher price for premium coffee products. However, profit margins have been declining slowly over the past five years due to cost pressures from wholesalers and the effects of intensified competition (Ibis World 2015).

### **Response from the industry**

Imported green coffee beans purchased by coffee manufacturers are predominantly sourced directly from either a cooperative, directly from the farmer, an offshore exporter or from an importer. This activity is mainly transactional rather than relationship-based, leading to a limited flow of information and potential problems in maintaining a secure supply.

Larger manufacturers are changing the structure of their activities to strategically align themselves with long-term suppliers, creating a dedicated and robust supply chain. This approach effectively connects the farmers with the manufacturers, providing positive collaboration and information exchange.

### **Tariffs**

Australia does not impose any tariffs or other import restrictions on either green coffee beans or roasted coffee.

## F Competitive Overview

The industry contains four dominant players: Nestlé Australia Ltd (Nestlé), Luigi Lavazza S.p.A, D.E. Holding Australia Pty Ltd and Canterella Holdings Pty Ltd. Despite the relatively high concentration of larger organizations, a medium level of market share competition is found in Australia. This is due to medium entry barriers and smaller organizations concentrating on niche products, which have offset any concentrated growth in the industry.

Concentration of market share has decreased over the last five years due to fragmentation in the industry. The industry has a large number of smaller businesses that service niche and local markets, particularly in the roasted coffee beans and roasted ground coffee product segments(Ibis World2015).

The industry is dominated by sales of instant coffee and Nestlé has the largest share of the instant coffee market with their Nescafé brand. Table 3 shows the market share of major competitors in the coffee manufacturing industry in Australia.

**Table3**

*Major competitors in the Australian coffee manufacturing industry (as at June 2015)*

Company	Market	Brands	Product segment
<i>Nestlé Australia Ltd</i>	54%	Nespresso	Roasted ground coffee capsules
		Andronicus	Roasted ground coffee Roasted coffee beans
		BuondiCaffé	Roasted ground coffee Roasted coffee beans
		Nescafé	Instant coffee
		International Roast	Instant coffee
		Nescafé Coffee-Mate	3-in-1 packages 4-in-1 packages
		Nescafé Dolce Gusto	Roasted ground coffee capsules
<i>Luigi Lavazza S.p.A</i>	25%	Lavazza A Modo Mio	Roasted ground coffee capsules
		Lavazza	Roasted ground coffee
		Piazza D' Oro	Roasted ground coffee capsules
<i>D.E. Holding Australia Pty Ltd</i>	11%	Harris	Roasted ground coffee
		Moccona	Instant 3-in-1 packages

<i>Canterella Holdings Pty Ltd</i>	6%	Vittoria Coffee	Roasted ground coffee Roasted ground coffee capsules
		Aurora Coffee	Roasted ground coffee capsules
		Delta Chicco Doro	Roasted ground coffee capsules
<i>Private label and other brands</i>	4%	Supermarket generic brands including Coles, Aldi, Woolworths and smaller brands from local and international organizations	Roasted ground coffee capsules
			Roasted ground coffee
			Instant coffee

*[Figures adapted from Aztec Scan Data and company-sourced data (major brands only listed).]*

## 2 The introduction of Nestlé

Nestlé is the world's leading Nutrition, Health and Wellness Company. Their mission of "Good Food, Good Life" is to provide consumers with the best tasting, most nutritious choices in a wide range of food and beverage categories and eating occasions, from morning to night. For well over a century, their commitment to producing foods that uniquely fulfill people's needs has been the secret ingredient in everything they make. Nestlé Australia is a subsidiary of Nestlé SA, [www.nestle.com](http://www.nestle.com). Nestlé Oceania employs more than 5,000 people, operates 12 factories, 5 distribution centers and 20 offices across the Oceania region - taking in Australia, New Zealand and the Pacific Islands. Whilst Nestlé is most well known for their confectionery products, this is a small part of their business. They are proud to have some of Australia's best loved brands such as MAGGI, ALLEN'S, NESCAFÉ, MILO, CARNATION, UNCLE TOBYS, KIT KAT, and PURINA.

Nestlé in society and Creating Shared Value key performance indicator	GRI	2013	2014	Page
<b>Economic</b>				
Total Group sales (CHF million) <sup>(a)</sup>	G4-EC1	92 158	91 612	5
Net profit (CHF million) <sup>(b)</sup>	G4-EC1	10 015	14 456	n/a
<b>Nutrition</b>				
Products meeting or exceeding Nestlé Nutritional Foundation profiling criteria (as % of total sales) <sup>(c)</sup>	G4-EC1	76.0	78.5	10,11,12
Renovated products for nutrition or health considerations <sup>(d)</sup>	G4-FP7	7 789	10 812	10,11,12
Products with increase in nutritious ingredients or essential nutrients <sup>(d)</sup>	G4-FP7	4 778	6 359	10
Products with reduction of sodium, sugars, trans fats, total fat, calories or artificial colorings <sup>(d)</sup>	G4-FP6	4 221	6 973	11,12
Products analyzed and improved or confirmed via 60/40+ programme (sales, CHF million) <sup>(e)</sup>	G4-PR1	33 001	33 233	10,11,12
Products containing Branded Active Benefits (sales, CHF million)	G4-FP7	6 836	6 687	10
Products featuring Nestlé Nutritional Compass labelling (% of sales worldwide) <sup>(f)</sup>	G4-PR3	92.5	92.8	13
Products with Guideline Daily Amounts (GDA) labelling on front of pack (% of sales) <sup>(g)</sup>	G4-PR3	99.3	79.7	13
Products with specific portion guidance (sales, CHF million) <sup>(h)</sup>	G4-PR3	26 700	26 456	14
Popularly Positioned Product SKUs <sup>(i)</sup>	G4-EC1	9 562	5 014	10

Popularly Positioned Products (sales, CHF million)	G4-EC1	11 803	12 205	10
Nestlé television advertising to children under 12 in compliance with policies on responsible marketing <sup>(i)</sup>	G4-PR7	98.3	99.9	16
Contraventions to the Nestlé Policy and Instructions for Implementation of the WHO International Code of Marketing of Breast-milk Substitutes <sup>(k)</sup>	G4-PR7	27	29	17
Infant formula marketing staff in higher-risk countries trained on the WHO Code (% of staff) <sup>(l)</sup>	G4-PR6	100	100	17
<b>Rural development</b>				
Farmers trained through capacity-building programmes		300 000	376 000	18.20.21
Markets covered by Sustainable Agriculture Initiative Nestlé (SAIN) programs		48	51	23.24
Direct procurement markets covered by SAIN programmes (%)		100	100	23.24
Percentage of suppliers that fully comply with the Nestlé Supplier Code	G4-FP1	74.0	73.0	19
Percentage of purchased volume fully compliant with the Nestlé Supplier Code	G4-FP1	92.0	95.0	19
<b>Water</b>				
Total water withdrawal (million m <sup>3</sup> )	G4-EN8	152	147	22
Total water withdrawal (m <sup>3</sup> per tonne of product)	G4-EN8	2.92	2.74	22
<b>Environmental sustainability</b>				
<b>Production volume</b>				
Total production volume (million tonnes)		52.1	53.7	n/a
<b>Materials</b>				
Raw materials used (million tonnes) <sup>(n)</sup>	G4-EN1	25.1	25.8	n/a
Materials for packaging purposes (million tonnes) <sup>(n)</sup>	G4-EN1	5.7	5.6	26
Packaging source optimization (kilotonnes saved)		66.6	45.8	26
<b>Energy</b>				
Total on-site energy consumption (pet joules)		97.7	95.8	26
<b>Nestlé in society and Creating Shared Value key performance indicator</b>				
	GRI	2013	2014	Page
Total on-site energy consumption (pet joules per tonne of product)		1.87	1.78	26
Total on-site energy consumption from renewable sources (% total)	G4-EN3	13.3	14.7	n/a
Total direct energy consumption (pet joules)	G4-EN3	67.1	65.5	26
Total direct energy consumption from renewable sources (% total direct)	G4-EN3	10.8	11.3	n/a
Total indirect energy consumption (pet joules)	G4-EN4	81.5	81.1	26
<b>Biodiversity</b>				
Total size of manufacturing sites located in protected areas (hectares) <sup>(o)</sup>	G4-EN11	32.9	18.8	28
<b>Emissions, effluents and waste</b>				
Direct GHG emissions (million tonnes CO <sub>2</sub> e)	G4-EN15	3.99	3.81	28
Direct GHG emissions (kg CO <sub>2</sub> e per tonne of product)	G4-EN15	76.0	71.0	28
Indirect GHG emissions (million tonnes CO <sub>2</sub> e)	G4-EN16	3.81	3.80	28
Indirect GHG emissions (kg CO <sub>2</sub> e per tonne of product)	G4-EN16	73.0	71.0	28
Total water discharge (million m <sup>3</sup> )	G4-EN22	91.0	87.0	24
Total water discharge (m <sup>3</sup> per tonne of product)	G4-EN22	1.74	1.63	24
Average quality of water discharged (mg COD/l)	G4-EN22	76.0	72.0	24
By-products (kg per tonne of product)	G4-EN23	29.1	28.9	26
Waste for disposal (kg per tonne of product)	G4-EN23	4.9	4.0	26
<b>Environmental sustainability governance</b>				
Manufacturing sites certified against ISO 14001 (% of total manufacturing sites)		91.0	92.0	n/a
<b>Human rights and compliance</b>				
Total number of significant product recalls or incidents of non-compliance	G4-PR2	10	12	n/a
Number of human rights impact assessments completed	G4-HR9	1	1	30
Number of employees trained on human rights		13 793	7 485	30
<b>Our people</b>				
Total workforce (number of employees) <sup>(a)</sup>		333 214	339 456	5
Total rate of new employee hires (%) <sup>(p)</sup>	G4-LA1	10.7	10.3	n/a
Total rate of employee turnover (%) <sup>(p)</sup>	G4-LA1	11.1	11.7	n/a
CARE gaps identified related to Business Integrity and HR <sup>(q)</sup>		146	32	32
Of which: Minor		130	32	32
Major		16	0	32

Critical		0	0	32
Lost-time injuries and illnesses rate (per million hours worked) (employees, on-site contract or sand on-site members of public) <sup>(m)</sup>	G4-LA6	2.34	2.35	33
Total record able injuries and illnesses rate(per million hours worked) (employees, on-site contractors and on-site members of public) <sup>(m)</sup>	G4-LA6	4.10	3.98	33
Total number of fatalities (employees, on-site contractors and on-site members of public) <sup>(m)</sup>	G4-LA6	12	5	33
Average hours of training per year per employee per category <sup>(f)</sup>	G4-LA9	23.0	28.8	35
Leadership positions held by women (%) <sup>(p)</sup>	G4-LA12	31.1	33.7	33
Local Management Committee members native to country in developing countries (%) <sup>(s)</sup>	G4-EC6	52.0	56.4	n/a

(a) Does not include joint ventures.

(b) Includes Nestlé's share in net result of joint ventures.

(c) 2014 assessment scope: 73.8% total Nestlé sales volume. We evaluate our products against the Nestlé Nutritional Foundation criteria, which are based on scientific and public health recommendations (WHO, Institute of Medicine (IOM) and others).

(d) Based on reports of approximately

75% of worldwide product development teams. Products can have 'less of one ingredient and 'more of another at the same time.

(e) In the 60/40 programme products

are tested with consumer panels and at least 60 of the 100 people must prefer the Nestlé product over the competitor's. This KPI reflects the dynamic nature of our 60/40+ programme. Assessment results are

valid for a maximum of three years, only if all parameters remain equal.

(f) Excludes total pet care and, for USA only, Dreyer's and licensed brands Haagen-Dazs and California Pizza Kitchen.

(g) 2014 figure is global. 2013 figure is EU 28 plus Switzerland, the Adriatic Region, Ukraine and Moldavia. Excludes plain coffee, tea and water, products for Nestlé Professional, gifting chocolate, seasonings, pet care, Nestlé Health Science and Nestlé Nutrition.

(h) Products sold as single servings and meeting/exceeding Nestlé Nutritional Foundation OR sold with/via a device or equipment delivering a serving meeting/ exceeding Nestlé Nutritional Foundation OR sold to caregivers with detailed instructions on adjusting servings to evolving nutritional needs. This currently represents only a subset of the portfolio with portion guidance.

(i) SKU count recalculated for increased accuracy and now only includes active SKUs.

(j) The percentage reflects Nestlé's

Full-year compliance to the stricter 35% children audience threshold as redefined in September 2011.

(k) Based on internal and external

Audits. Internal audits are conducted by HQ-based auditors (Nestlé Group Audit) and country-based auditors (Nestlé Market Audit). External audits were conducted by Bureau Veritas.

(l) We follow the FTSE4Good breast-

milk substitute marketing criteria, which classify countries as 'higher-risk' if they have mortality rates for under-fives of more than ten per 1000, or more than 2% acute malnutrition among under- fives. All other countries are 'lower-risk'.

(m) Includes joint ventures.

(n) 2013 data restated due to some of our large joint ventures reporting environmental data for the first time in 2013 but not having material Consumption data available at the time.

(o) Differences from 2013 due to correction of factory coordinates clarification of PA boundaries and sale of three factories.

(p) Covers Nestlé employees registered in the HR system (approximately 85% of all employees).

(q) CARE, our global external audit programme, is conducted by three audit companies and verifies that all employees and sites we own or operate comply with local legislation, our Corporate Business Principles and Code of Business Conduct. The audits take place every three years.

(r) Covers approximately 85% of all employees through a combination of manual submission from the markets and the training system.

Covers all Nestlé employees including joint v

## The main tables of Nestlé in 2014

### Consolidated income statement for the year ended 31 December 2014

In millions of CHF			
<b>Sales</b>	3	<b>91 612</b>	92 158
Other revenue		253	215
Cost of goods sold		(47 553)	(48 111)
Distribution expenses		(8 217)	(8 156)
Marketing and administration expenses		(19 651)	(19 711)
Research and development costs		(1 628)	(1 503)

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Other trading income	4	110	120
Other trading expenses	4	(907)	(965)
<b>Trading operating profit</b>	3	<b>14 019</b>	<b>14 047</b>
Other operating income	4	154	616
Other operating expenses	4	(3 268)	(1 595)
<b>Operating profit</b>		<b>10 905</b>	<b>13 068</b>
Financial income	5	135	219
Financial expense	5	(772)	(850)
<b>Profit before taxes, associates and joint ventures</b>		<b>10 268</b>	<b>12 437</b>
Taxes	14	(3 367)	(3 256)
Income from associates and joint ventures	15	8 003	1 264
<b>Profit for the year</b>		<b>14 904</b>	<b>10 445</b>
of which attributable to non-controlling interests		448	430
of which attributable to shareholders of the parent (Net profit)		14 456	10 015
<b>As percentages of sales</b>			
Trading operating profit		15.3%	15.2%
Profit for the year attributable to shareholders of the parent (Net profit)		15.8%	10.9%
<b>Earnings per share (in CHF)</b>			
Basic earnings per share	16	4.54	3.14
Diluted earnings per share	16	4.52	3.13

## Consolidated statement of comprehensive income for the year ended 31 December 2014

In millions of CHF			
<b>Profit for the year recognized in the income statement</b>		<b>14 904</b>	<b>10 445</b>
Currency retranslations			
– Recognized in translation reserve		2 660	(3 160)
– Reclassified from translation reserve to income statement		1 003	214
Fair value adjustments on available-for-sale financial instruments			
– Recognized in fair value reserve		191	9
– Reclassified from fair value reserve to income statement		(4)	(532)
Fair value adjustments on cash flow hedges			
– Recognized in hedging reserve		31	161
– Reclassified from hedging reserve		(87)	85
Taxes	14	5	290
Share of other comprehensive income of associates and joint ventures	15		
– Recognized in the reserves		83	40
– Reclassified from the reserves		(436)	—
<b>Items that are or may be reclassified subsequently to the income statement</b>		<b>3 446</b>	<b>(2 893)</b>
Remeasurement of defined benefit plans	10	(1 745)	1 632
Taxes	14	352	(848)
Share of other comprehensive income of associates and joint ventures	15	(153)	47
<b>Items that will never be reclassified to the income statement</b>		<b>(1 546)</b>	<b>831</b>
<b>Other comprehensive income for the year</b>	18	<b>1 900</b>	<b>(2 062)</b>

<b>Total comprehensive income for the year</b>		<b>16 804</b>	<b>8 383</b>
of which attributable to non-controlling interests		556	371
of which attributable to shareholders of the parent		16 248	8 012

## Consolidated balance sheet as at 31 December 2014

### Before appropriations

In millions of CHF		2014	2013
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	13/17	7 448	6 415
Short-term investments	13	1 433	638
Inventories	6	9 172	8 382
Trade and other receivables	7/13	13 459	12 206
Prepayments and accrued income		565	762
Derivative assets	13	400	230
Current income tax assets		908	1 151
Assets held for sale	2	576	282
<b>Total current assets</b>		<b>33 961</b>	<b>30 066</b>
<b>Non-current assets</b>			
Property, plant and equipment	8	28 421	26 895
Goodwill	9	34 557	31 039
Intangible assets	9	19 800	12 673
Investments in associates and joint ventures	15	8 649	12 315
Financial assets	13	5 493	4 550
Employee benefits assets	10	383	537
Current income tax assets		128	124
Deferred tax assets	14	2 058	2 243
<b>Total non-current assets</b>		<b>99 489</b>	<b>90 376</b>
<b>Total assets</b>		<b>133 450</b>	<b>120 442</b>

In millions of CHF		2014	2013
	Notes		
<b>Liabilities and equity</b>			
<b>Current liabilities</b>			
Financial debt	13	8 810	11 380
Trade and other payables	13	17 437	16 072
Accruals and deferred income		3 759	3 185
Provisions	12	695	523
Derivative liabilities	13	757	381
Current income tax liabilities		1 264	1 276
Liabilities directly associated with assets held for sale	2	173	100
<b>Total current liabilities</b>		<b>32 895</b>	<b>32 917</b>
<b>Non-current liabilities</b>			
Financial debt	13	12 396	10 363
Employee benefits liabilities	10	8 081	6 279
Provisions	12	3 161	2 714

Deferred tax liabilities	14	3 191	2 643
Other payables	13	1 842	1 387
<b>Total non-current liabilities</b>		<b>28 671</b>	<b>23 386</b>
<b>Total liabilities</b>		<b>61 566</b>	<b>56 303</b>
Equity	18		
Share capital		322	322
Treasury shares		(3 918)	(2 196)
Translation reserve		(17 255)	(20 811)
Retained earnings and other reserves		90 981	85 260
Total equity attributable to shareholders of the parent		70 130	62 575
Non-controlling interests		1 754	1 564
<b>Total equity</b>		<b>71 884</b>	<b>64 139</b>
<b>Total liabilities and equity</b>		<b>133 450</b>	<b>120 442</b>

## Consolidated cash flow statement for the year ended 31 December 2014

In millions of CHF			
Operating activities			
Operating profit	17	10 905	13 068
Non-cash items of income and expense	17	6 323	4 352
<b>Cash flow before changes in operating assets and liabilities</b>		<b>17 228</b>	<b>17 420</b>
Decrease/(increase) in working capital	17	(114)	1 360
Variation of other operating assets and liabilities	17	85	(574)
<b>Cash generated from operations</b>		<b>17 199</b>	<b>18 206</b>
Net cash flows from treasury activities	17	(356)	(351)
Taxes paid		(2 859)	(3 520)
Dividends and interest from associates and joint ventures	15	716	657
<b>Operating cash flow</b>		<b>14 700</b>	<b>14 992</b>
Investing activities			
Capital expenditure	8	(3 914)	(4 928)
Expenditure on intangible assets	9	(509)	(402)
Acquisition of businesses	2	(1 986)	(321)
Disposal of businesses	2	321	421
Investments (net of divestments) in associates and joint ventures <sup>(a)</sup>	15	3 958	(28)
Outflows from non-current treasury investments		(137)	(244)
Inflows from non-current treasury investments		255	2 644
Inflows/(outflows) from short-term treasury investments		(962)	400
Inflows from other investing activities <sup>(b)</sup>		294	1 273
Outflows from other investing activities		(392)	(421)
<b>Cash flow from investing activities</b>		<b>(3 072)</b>	<b>(1 606)</b>
Financing activities			
Dividend paid to shareholders of the parent	18	(6 863)	(6 552)
Dividends paid to non-controlling interests		(356)	(328)
Acquisition (net of disposal) of non-controlling interests		(49)	(337)
Purchase of treasury shares		(1 721)	(481)
Sale of treasury shares		104	60
Inflows from bonds and other non-current financial debt		2 202	3 814

Outflows from bonds and other non-current financial debt	(1 969)	(2 271)
Inflows/(outflows) from current financial debt	(1 985)	(6 063)
<b>Cash flow from financing activities</b>	<b>(10 637)</b>	<b>(12 158)</b>
Currency retranslations	42	(526)
<b>Increase/(decrease) in cash and cash equivalents</b>	<b>1 033</b>	<b>702</b>
Cash and cash equivalents at beginning of year	6 415	5 713
<b>Cash and cash equivalents at end of year</b>	<b>7 448</b>	<b>6 415</b>

(a) *Mainly relates to the partial disposal of L'Oréal shares. The Group sold part of its shares to L'Oréal for a price of CHF 7342 million (see Note 15) in exchange for the remaining 50% stake in Gal derma for an equity value of CHF 3201 million (see Note 2) and cash of CHF 4141 million.*

(b) *In 2013 mainly relates to the disposal of Givaudan shares.*

### 3 Nestlé Australia

#### A About Nestlé Australia

Nestlé Australia Ltd (Nestlé) is a wholly owned subsidiary of Nestlé S.A. Group, the world's largest food and beverage Company by revenue (Ibis World 2015). Nestlé's large range of product categories includes beverages, milk products, confectionery, pet care, cooking aids such as spices and ice-cream.

For the 2014 calendar year, Nestlé Australia experienced a 4.4 per cent decrease in sales revenue to a little over AUD2 billion, and a corresponding 30 per cent decrease in net profit to AUD104.5 million. Nestlé's board attributed the decline in sales revenue to the divestment of one of the group's businesses in 2013, as well as the general downturn in the economic environment.

According to the chair of the board, Elizabeth Proust, Nestlé Australia's performance was 'bolstered by the growing popularity of its Nespresso brand'.

#### B Nestlé's coffee products

Successful product differentiation strategies have enabled Nestlé to offer a variety of coffee products across its Nescafé coffee range. The Nescafé range includes four product lines: roasted ground coffee capsules; instant coffee; 3-in-1 packages; and 4-in-1 packages.

Nestlé Australia has three main coffee brands for private customers in Australia: Nescafé, International Roast and Nespresso. Nestlé sells five coffee brands to business customers in the Australian market: Nescafé, International Roast, BuondiCaffé, Andronicus and Nespresso.

Nescafé Dolce Gusto is a coffee capsule product aimed at the mid-range market, while Nespresso targets high end consumers. Various aspects of the products reflect this positioning. For example, Nespresso packaging is made from aluminum, giving the product a premium feel. In comparison, the Nescafé Dolce Gusto packaging is made from plastic.

In its instant coffee sub-segments, Nestlé has split its range using spending and lifestyle criteria.

Nescafé Blend 43 is positioned as an 'everyday drink' with the main purpose being convenience, and the price point is at the lower end of the market. International Roast is positioned as a cheap, no-frills brand, with a very low price point.

To capture those consumers who prefer a higher grade of instant coffee and still want convenience, Nestlé launched the Nescafé 'Gold' brand, made '100 per cent from Arabica beans', targeting a higher end of the instant coffee market (Market Line 2013).

The Coffee-Mate brand is for consumers who prefer convenience and a 'milkier' style of instant coffee. The range offers various types of powdered coffee and creamers, packed as 3-in-1 and 4-in-1 packages.

**Table4**

*Nestlé Australia's coffee product range (as at August 2015)*

Brand	Product segment	Product names	Product range
<i>Nespresso</i>	Roasted ground coffee capsules	Grand Cru	24 products
<i>Nescafé</i>	Roasted ground coffee capsules	Dolce Gusto	14 products
	Instant (soluble) coffee	Blend 43	5 products
		Gold	2 products
		Short Black	1 product
		Azera	1 product
		Green Blend	1 product
		Café menu	13 products
		Milano	1 product
	3-in-1 packages	Coffee-Mate	1 product
4-in-1 packages	Coffee-Mate	1 product	
<i>International Roast</i>	Instant (soluble) coffee	–	1 product
<i>Andronicus</i>	Roasted coffee beans	Bar Cosmopolitan	1 product
	Roasted ground coffee	Da Fiore	2 products
<i>BuondiCaffé</i>	Roasted coffee beans	Black	1 product
	Roasted coffee beans	Zandarelli	1 product
	Roasted coffee beans	Nouvé Beans	1 product
	Roasted coffee beans	Monseratto	1 product
	Roasted ground coffee	Decaffeinato Grind	1 product

*【Source: Nestlé-Nespresso, Nescafé Australia at <https://www.nescafe.com.au/all-products/>, Nestlé Professional at <https://www.nestleprofessional-beverages.com.au/brands/> (accurate as at August 2015)】*

## 4 About Nespresso

### A History

#### Global

Nespresso is the fastest growing brand in Nestlé's coffee portfolio and consists of roasted ground coffee capsules and coffee machines.

Originally, Nespresso intended its coffee machine and coffee capsule 'system' to target offices and restaurants. It was evident by 1988 that product sales were lower than expected, so Nestlé expanded its target market to include high-income private individuals and used a mail-order system to distribute the coffee capsules.

Growth was significant and Nespresso is now sold in 62 countries. There are over 400 company-owned retail outlets, known as 'boutiques', in 55 countries, with a global turnover of USD4.3 billion in 2013 (Bloomberg 2013).

## Australia

Nespresso entered the Australian market in 1997 as the first coffee capsule brand in the market, but it took another 11 years for demand for the capsule coffee to start to demonstrate strong growth. Nespresso opened its first boutique in Australia in 2010 in Sydney's Pitt Street Mall, coinciding with a retail precinct upgrade.

## B Strategic Aims

Nespresso's strategic aims are:

- Creating long-lasting consumer relationships: This includes developing and leveraging customer relationships through Club Membership;
- Creating the highest quality 'Grand Cru' coffee capsules for consumers and Club Members. This means that the coffee beans are selected from the top one to two per cent of the world's green coffee bean supply;
- Creating sustainable business success. This includes Nespresso's commitment to sustainable coffee production programs with suppliers, and capsule recycling. This also means creating supplier relationships to minimize risk of supply reduction.

## C Market share and size in Australia

Nespresso is the highest selling coffee capsule brand in Australia with 1.4 million Australians owning a Nespresso coffee machine in 2014. It is estimated that Nespresso's share of the Australian coffee capsule market in 2014 was 51 per cent.

However, annualized sales growth, which reached 30 per cent in 2009, dropped to 20 per cent in 2011. As shown in Table 5, sales growth slowed again in 2014, to around 10 per cent.

**Table5**

*Sales Growth for Nespresso coffee capsules*

	2009	2010	2011	2012	2013	2014
Sales growth per year	30%	20%	20%	18%	13%	10%

*[All figures are indicative. Sources: Reuters 2014 & Franklin & Pradhan 2015, M/C Journal 2012, author contributed.]*

## **D Nespresso's customers**

### **Private customers (individuals)**

High income households are an important target market for Nespresso, as are individuals who aspire to be perceived as affluent. Individuals in these households are generally time-poor and value convenience without compromising quality.

This target market appreciates the exclusivity of the brand. There are perceived benefits of being a Club Member. The perception is that members are sophisticated people who appreciate quality coffee.

### **Business customers**

Nespresso targets offices, restaurants and airlines.

Businesses use Nespresso coffee to demonstrate to customers and staff that they value their business and service to the organization.

Nespresso coffee machines are also found in 30 per cent of the world's 2400 Michelin-starred restaurants (BRW 2013). Using a Nespresso machine is less expensive than hiring a barista and provides a quick and consistently high quality coffee for consumers.

Nespresso has also targeted first and business class sections of airlines, giving this valuable target market the opportunity to sample its products.

## E Nespresso's strategic approach

### Positioning

Nespresso identified a gap in the coffee market for premium coffee options for in-home consumption. Exploiting the trend of premiumisation of coffee preferences and the desire for in-home convenience, Nespresso positioned itself as an aspirational, exclusive brand supporting what the company calls 'the ultimate coffee experience'.

This is reinforced by sophisticated black packaging, the sleek finish of the machines, the perceived high product quality and the sophisticated naming conventions of the products.

The capsules are called 'Grand Cru', a term from the wine industry where 'cru' means vineyard - usually one that is known for its superior quality. The machine names sound European and the capsule flavors have Italian names.

Convenience is another pillar of the positioning strategy. The brand premise is everyday luxury, where Café-quality coffee can be conveniently enjoyed at home. The product offering of intuitive coffee machines and individual capsules ensures an easy, quick, and mess-free method of preparing a cup of high-quality coffee.

The range of flavors and the different types of coffee create an impression of customization and variety similar to that offered by cafés.

### Product strategy

Nespresso's product offering is a high-quality cup of coffee. This means, according to Nespresso, that they are 'not selling a machine and then a capsule, they're selling a result' (Kashani 2000).

#### *Private customers (individuals)*

- Coffee capsules

The coffee capsule range offered by Nespresso supports the positioning strategy. Roasted ground coffee traditionally comes in bags of 500 grams, leaving consumers with only one type of coffee in the home.

Nespresso offers 24 different flavors of coffee capsule including its 'Limited Edition' version. The Limited Edition version is released and sold for a limited time each year before being replaced by another version. This strategy adds variety to the range and provides a sense of exclusivity to customers.

- Coffee machines

Nespresso coffee machines are a bespoke design used in conjunction with the Nespresso coffee capsule. According to Nespresso, this is called the 'Nespresso system':

"The interaction between the Nespresso capsule and the Nespresso machine is designed to work as

one to deliver the perfect cup of coffee [every time]...by controlling every variable”.

Understanding that its core business is coffee and not engineering, Nespresso collaborated with coffee machine specialists to build appliances that accepted the Nespresso capsule. Licensing agreements with established manufacturers and retailers provided access to reputable distributors with existing networks. The manufacturers that produce the machines are respected and trusted within the appliance industry. The machines are co-branded with Nespresso and the manufacturer's name, for example, DeLonghi Nespresso Latissimi Pro.

Having control over the workings of its own machine enables Nespresso to regulate the water pressure and temperature to levels that are optimal for its capsules.

Some industry analysts calculate that Nespresso does not make much (if any) profit from the sale of coffee machines. Rather, its business model is based around the sale of affordable machines, enabling the earning of revenue through the sales of capsules (Matzner et al 2013).

Reinforcing the customization of the positioning strategy, some models are available in a range of colours or made from 30 per cent recycled materials. The machines are sold with after-sales service arrangements like free machine pick-up and a free replacement coffee machine in the event of a malfunction or breakdown.

The design of the Nespresso coffee machines is continually evolving, with six new models launched between 2012 and 2014 including models that heat and froth milk. The new models possess sophisticated technology with features including pre-programmed settings for coffee options and a tactile interface that memorizes the favorite cup height of the drinker.

#### *Business customers*

- Coffee capsules

The Nespresso coffee capsules offered to the business customer market vary from those sold in the consumer market as the range is smaller and the varieties differ.

- Coffee machines

There are three Nespresso coffee machines designed for the business market. These are aimed to appeal to a range of company sizes and coffee-making frequencies. The largest machine has the ability to make four cups of coffee at a time, with or without hot milk, and is designed to compete directly with commercially-designed espresso machines. The second largest machine can make two coffees at once, and also has a milk-heating option. The smallest machine makes a single coffee with hot water only.

- Accessories, merchandise and customized payment systems

As part of the product strategy, biscuits, sugar and tea are available for purchase by business customers. The brands and packaging of the accessory products are premium quality and complement the Nespresso branded merchandise of paper and ceramic cups, spoons and stirrers, glasses and capsule display cases.

A payment system, similar to a vending machine, can be incorporated into the design of a machine, enabling the business customer to elect to have optional user-pays functionality.

**Pricing approach**

The pricing strategy supports the positioning of Nespresso, and is reinforced by the perception that a higher price-point is an indicator of a higher quality product.

According to the Australian consumer advocacy group Choice, the Nespresso coffee capsules are among the most expensive coffee (on a per gram basis) sold in Australia.

The purpose-built Nespresso coffee machines are priced in the middle of the range.

Other manufacturers produce capsules that fit the Nespresso system. Table 6 provides a price comparison of a number of these.

**Table6**

*Comparison of prices with a sample of Nespresso-compatible capsules*

Company	Brand – Nespresso compatible capsules	Cost per capsule	Weight of capsule	Where to buy
<i>Nestlé Australia Ltd</i>	Nespresso Grand	68 – 84 cents	4 – 6 grams	Online, company owned boutiques,
<i>D.E. Holding Australia</i>	Piazza D’Oro	66 – 74 cents	5.2 grams	Supermarkets.
<i>Canterella Holdings Pty</i>	Vittoria Coffee	70 cents	6.5 grams	Supermarkets.
<i>Aldi Supermarkets</i>	Aldi Espresso	37 cents	5 grams	Aldi supermarkets
<i>Mad Coffee Capsules</i>	Mad Coffee	50 – 70 cents	6.3 grams	Online

*【Prices correct as at June 2015】*

**Places of purchase**

*Business customers*

Business customers can order their capsules via the website, telephone or email, and the coffee machines by

contacting Nespresso directly.

#### *Private customers*

- Coffee capsules

Traditionally, Nestlé has sold its products through food retailers. However, Nespresso has adopted a direct approach and now sells its coffee capsules using online sales, telephone sales and company-owned retail boutiques. The distribution strategies all support the positioning of premium, high quality product and service.

In order to purchase the Nespresso capsules, each customer must register to become a Nespresso Club Member. There is no cost to become a member.

- Coffee machines

Coffee machines can be purchased through appliance retailers, department stores, online retailers, directly from the manufacturer or from Nespresso. The Nespresso website and customer service centres provide sales support and technical advice.

#### *Customer service center sales*

Telephone sales are available 24/7, through customer service centers, where customers can 'connect with 1500 knowledgeable coffee specialists by phone'. The staff process orders and assist with service and advice. It is estimated that around 20 per cent of total product sales to private customers occur through the customer service centers.

#### *Online sales*

The website has a dual role of providing promotional information and e-commerce facilities. It provides detailed descriptions of the coffee capsule manufacturing process and their use, as well as information for Club Members. It is supported by a mobile app for online orders.

There is a facility to log-in to the Nespresso site enabling the company to monitor member activity including the pages viewed, and how long a member stays on the site.

Online and telephone sales are delivered within three business days in metropolitan areas (four business days in regional areas) at a cost of AUD6 per delivery. Free delivery is offered for orders over 200 capsules to reward loyal customers and encourage higher sales per customer.

To reinforce the convenience and exclusivity of the brand, Nespresso also offers a 'Twilight' (same day) delivery service and a 'Next Day' delivery service at extra cost.

Around 50 per cent of total product sales to private customers are completed through the website.

### *In store sales*

The Nespresso retail outlets, or boutiques, are located in expensive, high-end retail areas. In Australia, each boutique is situated in a shopping precinct that targets medium to high income customers, allowing Nespresso to capitalize on large numbers of passing pedestrian traffic that correlates to their target market.

The boutiques represent the brand with contemporary, upmarket décor, softened lighting, polished black tiles and elegant and eye-catching product displays. Staff, extensively trained in product knowledge and coffee preparation, wear suits in line with the sophisticated environment. Some boutiques offer a designated 'Club Lounge', an exclusive area partitioned from other customers. NirWegrzyn, CEO of design agency Brand Opus, notes that the exclusive lounge space gives Nespresso drinkers 'a sense of cultural belonging that taps directly into the sophisticated global lifestyle they seek to achieve' (Khamis 2012).

It is estimated that 30 per cent of Nespresso's total product sales to private customers are completed through these retail outlets.

### *Retail analytics*

As Nespresso owns all its retail stores, it has full access to all retail information. Nespresso can gauge foot traffic, sales volumes, sales per transaction and most popular product lines as well as employee data on sales conversions and volumes. Nespresso can build in additional data collection at the point of sale, including spot marketing research aspects such as lifestyle and attitudinal profiling.

## **Marketing communication strategies**

### *Advertising*

According to Nespresso, in 2006 George Clooney, the internationally recognized actor from the United States, was selected by Club Members as the brand ambassador. He was subsequently used in print and television commercials in key global markets, targeting existing and potential customers. Industry analysts say that using Clooney was one of the turning points for Nespresso internationally. Since 2008 Clooney has been used in Australia in outdoor, print and online advertising.

According to Nicole Parker, Nespresso marketing manager for Australia and Oceania, advertising featuring Clooney is used to communicate the brand and is supported by a local, product-focused message specifically tailored to the Australian market.

Magazines are one of the key media used by Nespresso. By targeting titles with a readership that is aligned with Nespresso's premium lifestyle positioning, the company can influence consumers and raise awareness of complementary products outside the category, which are also part of that environment (Marketing Magazine 2014).

In 2012, Penelope Cruz was used as a second brand ambassador in Nespresso advertising. Mr. Franz Niedermair, VP-marketing at Nespresso in USA, explained the rationale for using Cruz:

“now we are excited to move into the second phase, using a celebrity that not only lets us stay true to our European heritage, but epitomizes the elegance and sophistication the brand stands for”  
(Advertising Age 2012).

MS Cruz’s advertisements were used in Australia on Nespresso’s social media sites.

### *Publicity*

Due to the company’s relationship with magazine titles, editorial opportunities can also be leveraged. The popularity of the brand and the global appeal of the brand ambassadors, combined with being the market leader, enable Nespresso to command high levels of editorial space in both offline and online publications.

Nespresso sponsors key international events including the Cannes Film Festival, the St Moritz Polo World Cup on Snow, an international golf series called the Nespresso Trophy, the Bocuse d’Or, a prestigious competition between the top chefs in the world in Lyon, France, and the America’s Cup. Such sponsorships create opportunities for Nespresso to feature in editorial reports on the events.

In Australia, Nespresso sponsors the Gourmet Traveler Hotel Awards. Gourmet Traveler is a high-end travel magazine that features luxury food, accommodation and articles on travelling experiences. The sponsorship enables Nespresso to reinforce its positioning with both retail and business customers, extending the brand’s reach and differentiation.

### *Digital marketing*

In addition to an extensive website, Nespresso utilizes online banner advertising and interactive social media campaigns. The latest campaign asks Club Members to create their favorite Nespresso coffee and then share it on the social networking platform Twitter.

The social media platforms enable Nespresso to engage with potential customers and reinforce its value proposition to existing customers. Cross-referencing the social media analytics with customer history can assist in building up a hybrid profile of behavioral and lifestyle characteristics.

### *Customer referrals*

Customer referrals account for more than 50 per cent of new customers. This indicates high customer satisfaction and brand loyalty as existing customers use word-of-mouth to endorse and promote the brand. Further, existing customers demonstrate to potential customers how to use the machine, invite sampling and generate a positive experience.

## Customer retention strategies

### *Exclusivity of using the capsules in the coffee machines*

Nespresso coffee machines are widely available, and once purchased tend to lock the customer into using exclusively the Nespresso capsule product. However, as the demand for coffee capsules has increased, a range of third-party Nespresso compatible capsules have become available and this has the potential to dilute Nespresso's market share.

### *Marketing communications*

The marketing communication strategies assist in making the customer feel secure in their product purchase and reinforce the benefits of the brand to customers, including the feeling of exclusivity and sophistication.

### *Nespresso Club*

In order to purchase capsules from Nespresso, a customer needs to sign up to become a member of the Nespresso Club. The global magazine for Club Members is the bi-annual N magazine, available as a hard copy, online or through an app. The magazine promotes an aspirational, luxury lifestyle through its content and presentation.

### *Club Member data collection*

According to Nicole Parker, collecting data on their Club Members:

“...allows us...to build relationships with club members. We learn their coffee consumption habits; we learn how frequently they consume coffee, which of our coffee they prefer to others. That then allows us, from a marketing point of view, to target more in line with their behaviors.” (Marketing Magazine 2014).

The Nespresso Club membership enables Nespresso to consolidate their information on their customers' purchasing history.

## **F Key challenges**

### **Environmental issues**

It is estimated that coffee capsules can take more than 500 years to decompose due to their plastic and aluminium packaging (Packaging News, 2014). In order for capsules to be recycled satisfactorily, their lids must be removed and the capsules themselves must be cleaned of all coffee.

According to Nespresso, 'by 2013 we were able to collect 75 per cent of all capsules sold worldwide'. Jon Dee, founder of National Recycling Week, Planet Ark and National Tree Day, has challenged this claim as he has stated there isn't any evidence to support this statement. Since Mr. Dee has publically made this comment, there have been numerous stories in the Australian media that have been critical of the packaging and the inability to recycle capsules.

Nespresso has conceded to concerns about its environment programs, stating 'it's not optimal yet'. Consumers can return their used capsules to 15 Nespresso retail outlets in Australia. Nespresso has also made agreements with a select number of florists in the major metropolitan markets of Sydney and Melbourne for customers to return their used capsules to for recycling. Ms. Parker said that other alternatives are being considered that include providing customers with pre-paid envelopes to return used capsules.

The Swiss-based Ethical Coffee Company has developed a range of Nespresso-compatible capsules made entirely out of biodegradable cornstarch, which were launched in Australia in December 2014.

### **Sustainability and social responsibility in the value chain**

Since 2003, Nespresso has worked with farmers to help change agricultural practices, and increase the production of quality coffee. There are over 60 000 farmers who have joined Nespresso's sustainability program. This program helps farmers achieve high certification standards in water management, educates them on the fair treatment of their workers and supports good farm management practices. Nespresso aims to eventually source 100 per cent of their Grand Cru range through the sustainability program, with current levels at 84 per cent. By contracting suppliers to their sustainability program, Nespresso can better manage and monitor the quality of the coffee. In 2013 a price payment system that pays farmers 30 to 40 per cent above the standard market price for coffee was introduced.

In 2014, Nespresso introduced a series of advertisements featuring George Clooney that promote its sustainability program.

### **Protecting the Intellectual Property**

To protect its market share and intellectual property, Nespresso registered 1700 patents in the European Union for its machine and capsule technology. The patents expired in 2012. The expiration of these patents saw a surge in competitors offering capsules that are compatible with the Nespresso coffee machine, to capitalize on the increase in demand for coffee capsules.

As new competitors entered the market globally and in Australia, Nespresso changed the design of their machines. The Nespresso machine models 'Pixie', 'U' and 'Inissia' are using new, thinner injectors which are not able to pierce the capsule lid of some competitors' capsules and in some cases, have been known to crush the capsule. According to Nespresso, this is 'part of our ongoing development'.

Nespresso has recently taken out a patent in the United States for its latest machine, Vertuoline, which has dome-shaped capsules. All patents taken out by Nespresso do not apply in the Australian market.

## G Competitive pressures in the coffee capsule product segment

In Australia, competitors are emerging in different forms along the supply chain, primarily producing their own brand of Nespresso-compatible coffee capsules. It is estimated that there are at least 50 different brands of Nespresso-compatible coffee capsules available in the Australian market.

Competitors in the coffee capsule product segment include:

- Existing coffee brands who are established in the market with their instant and roasted ground coffee brands, like D.E. Holding Australia Pty Ltd who are selling their capsules online and in supermarkets;
- Supermarket retailers like Aldi, producing and selling their own generic private label brands of coffee capsules, with a low end price point; and
- Emerging coffee manufacturers who are:
  - specialist coffee capsule manufacturers, sourcing both locally- and internationally-grown coffee and selling their capsules online;
  - Cafés and coffee shops, using their own roasted ground coffee and selling ton-site through their café or coffee shop.

## H Conclusion

Nespresso is a profitable brand for its parent, Nestlé. As the first coffee capsule brand to enter the market in Australia, Nespresso has developed a large market share, with a strong brand presence with key strengths. However, Nespresso's market share is eroding, as more competition enters the market. Nespresso is also facing negative publicity associated with their packaging and recycling efforts.

### Questions:

1. Elaborate the basis of competition for the Australia coffee manufacturing industry in terms of demand, choice, price, costs and current and potential risks. Identify three key success factors of this industry.
2. Assess the current performance of Nespresso in light of the strategic driver analysis. Key strategic drivers of an organization include: markets, products, customers, channels, and competitive advantage. Describe the strategic drivers of Nespresso from the above aspects and provide examples of how Nespresso is performing against each of these strategic drivers.

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