



Syddansk Universitet

Competitive Advantage through Innovation

Brem, Alexander; Maier, Maximilian; Wimschneider, Christine

Published in:
European Journal of Innovation Management

Publication date:
2016

Document version
Final published version

Citation for pulished version (APA):
Brem, A., Maier, M., & Wimschneider, C. (2016). Competitive Advantage through Innovation: The case of Nespresso. European Journal of Innovation Management, 19(1), 133 - 148.

General rights

Copyright and moral rights for the publications made accessible in the public portal are retained by the authors and/or other copyright owners and it is a condition of accessing publications that users recognise and abide by the legal requirements associated with these rights.

- Users may download and print one copy of any publication from the public portal for the purpose of private study or research.
- You may not further distribute the material or use it for any profit-making activity or commercial gain
- You may freely distribute the URL identifying the publication in the public portal ?

Take down policy

If you believe that this document breaches copyright please contact us providing details, and we will remove access to the work immediately and investigate your claim.

Competitive advantage through innovation: the case of Nespresso

The case
of Nespresso

Alexander Brem
University of Southern Denmark, Sønderborg, Denmark

Maximilian Maier

Justus-Liebig-University, Giessen, Germany, and

Christine Wimschneider

Friedrich-Alexander-University, Nuremberg, Germany

133

Received 22 May 2014
Revised 5 March 2015
Accepted 3 April 2015

Abstract

Purpose – The purpose of this paper is to describe how Nespresso achieved competitive advantage through innovation by changing the rules of the game in its industry.

Design/methodology/approach – Nespresso was analyzed based on public available secondary data, in combination with related academic concepts on innovation and competitive advantage.

Findings – The company succeeded by the thorough application of a strategy that, through perfect alignment, allowed the company to reach a unique market position. However, as described in the case, it took a relatively long time and the company came close to failure several times. Before the current situation of the company, it remains challenging in the future as well. Hence, the Nespresso story provides interesting space for discussion and learning about what innovation is, how innovation emerges, and under which circumstances innovation can serve as a source for competitive advantage.

Research limitations/implications – Especially given the current market situation, the case offers different starting points for discussion about innovation and long-term company success.

Practical implications – Especially before the current market situation, the case offers different starting points for discussion about innovation and the success of a company on the long term. The case is designed to give practitioners a better understanding on what an innovation is, and how competitive advantages can be linked to innovation.

Originality/value – This case of Nespresso is a unique combination of the concepts of innovation and competitive advantage. It serves as an example of an innovation, which was not successful from the scratch, but evolved over time and is still developing. As many innovations went through such a non-linear process, this case offers interesting lessons learned for academics as well as for practitioners.

Keywords New technology, Innovation, Diffusion, Business strategy, Competitive advantage, Intellectual property

Paper type Case study

Structure of the case

This case is organized as follows. First, the food and beverage market is introduced. Second, an overview of customer behavior in this particular market is given. Next, Nespresso's unique strategic approach and business development are presented and analyzed. Finally, the authors discuss whether the Nespresso concept can be considered (as) an innovation, and whether it can serve as a foundation for long-term competitive advantage.

Redefining customer value

The food and beverage industry has a modest growth rate of 3 percent and is highly competitive, with powerful retailers, low consumer loyalty, low-profit margins, and frequently, mass market sales (Hungenberg, 2012; Reuters, 2012). Successful firms in this industry often must apply cost and price leadership strategies to live up to the



expectations of price sensitive customers. Consequently, companies operating in this market are therefore constantly under pressure to reduce costs and prices.

In contrast, consumers in the luxury goods market (e.g. fashion, cosmetics, cars) show a strong tendency to buy high-priced products, and have the propensity to pay a price premium if they perceive an additional, individual value. Therefore, brand strategies for luxury goods focus on differentiation in order to create a completely new value, or to add further features that are useful for promoting the brand (Matzler *et al.*, 2013). As a result, for example, clothes with designer labels can be successfully positioned at a significantly higher price point than unbranded goods. There are also differentiated groceries that exclusively sell valuable brands or features for specifically targeted customers (e.g. vegan, and organic food). However, in the food industry, this only works on a smaller scale compared to other industries; for instance, buyers will unlikely increase their propensity to pay for a common slice of toast branded with a designer symbol if it is significantly more expensive than unbranded toast. Micro economic theory teaches prices for commoditized goods have high elasticity unless customers perceive a sustained differentiated value. Therefore, regarding the toast example, customers would not pay a substantially higher price for branded toast vs unbranded toast (*ceteris paribus*). In this context, Nespresso, an independent operating subsidiary of the Nestlé Group, is a special case for a commoditized product (coffee) compared to other players in this market. Nespresso charges between \$0.60 and \$1 per capsule (five grams of espresso); given there are 454 grams per pound, this translates to charging – up to \$91 per pound of espresso. Compared to Lavazza, a premium brand charging approximately \$8.50 per pound of espresso, this is a price premium of about 970 percent. Consequently, Nespresso is “the most expensive coffee in the world” (Markides and Oyon, 2000, p. 297). Nespresso’s tremendous success shows there are circumstances under which consumers are willing to pay a disproportionately high price for a comparable product. Our analysis focusses on how Nespresso has been able to reach such a position in the market.

A new way of drinking espresso – the Nespresso strategy

Nespresso developed a clear concept that successfully positioned its brand in the market. The company managed to upgrade espresso to a lifestyle product and turned the common process of drinking coffee into an experience. For sure, espresso has long been a lifestyle product in many countries such as Italy; but in a cafe or restaurant, not at home. The company’s vision has been to convince customers that with a Nespresso machine and its capsules, they can enjoy the type of premium coffee at home that they would otherwise only get in cafeterias or coffee bars in Italy (Nestlé, 2014).

This goal was achieved by offering appealing and exclusively designed machines and capsules. The capsules’ aluminum casings are colored in a different shade depending on the kind of coffee it contains. Further, the machines are available in several stylish colors and in 40 different versions. The company’s basic range of Nespresso coffee, called the Grand Crus, covers 22 different types of capsules; customers can choose between nine Espressos, three Lungos (suitable for cappuccinos or café lattes), and four pure origins. The latter contain distinctive coffee from a single region, thus emphasizing the uniqueness of Colombia, Ethiopia, India, or Brazil as prominent countries of origin for coffee. Four decaffeinated and three flavored variations capsules complete the in-home portfolio. Furthermore, there are nine varieties of Grand Crus for consumption outside the home (out-home), and

new, seasonal, and limited edition tastes are frequently released. With this variety, Nespresso addresses the diverse tastes of demanding coffee drinkers (Nespresso, 2014a). Customers can also purchase a large variety of accessories including branded cups, Nespresso milk frothers, classy storage devices for the capsules and recently also exquisite biscuits and mini chocolate bars as coffee side dishes (Nespresso, 2014b, 2015). These accessories allow the company to cooperate with other luxury brands such as Porsche design, and to launch versions for specific target groups such as car enthusiasts. The significant effort that is invested in relation to the equipment distinguishes Nespresso from a basic commodity and classifies it as a lifestyle product. In addition to its fashionable design, the machines can be handled easily; as the TV commercial points out, “just one touch creates the perfect coffee.” To ensure the final result lives up to the company’s first class image, only a fraction of the worldwide coffee harvest is considered suitable for the Nespresso system (Nespresso, 2014c).

The second element that distinguishes Nespresso is the firm’s distribution channel. Nespresso customers do not buy the equipment or capsules in regular retail shops, but instead order them online, via telephone, or buy them in one of Nespresso’s exclusive boutiques. Due to the self-imposed obligation of providing world class service (Markides and Oyon, 2000), the company ensures that when customers call to place an order, no customer waits more than three rings before talking to a representative, and no customer ever has to leave a message on an answering machine. However, personal customer contact is not only achieved by taking orders online or via phone calls, Nespresso ensures a close and exclusive customer relationship through their branded retail boutiques. In the year 2000, the first boutique was opened on Rue Scribe in Paris as a concept store; today they can be found in most major cities worldwide (Nespresso, 2014d). They are only located in the immediate vicinity of well-known luxury and designer brands; being a part of the world’s grandest urban shopping boulevards alongside Louis Vuitton, D&G, Prada, Hermès, and Emporio Armani is part of the company’s premium branding strategy. To achieve brand equality with its premium retail neighbors, much emphasis is placed on expensive and chic interior designs for its boutiques (Jones, 2013). Moreover, partnerships are formed with designers, such as the Indian fashion stylist Manish Arora, who design limited edition machines and do window and in-store installations for Nespresso boutiques worldwide (Liganova, 2014; Nespresso, 2014e).

Finally, Nespresso boutiques can also be found in famous exclusive flagship stores such as the KaDeWe in Berlin, les Galleries Lafayette in Paris, and Harrods in London. The brand’s unique distribution system starts even earlier regarding its strictly organized cultivation procurement system. As previously mentioned, coffee beans are meticulously selected, fair prices are paid to local growers of Nespresso beans, and the production system fulfills the highest industry quality standards – all necessary measures to live up to its reputation as a luxury brand (Chwallek, 2013a).

Over 70 percent of the 9,500 Nespresso employees worldwide work in direct customer contact; therefore, it is important to ensure that a unique customer approach is adopted by everyone involved with selling Nespresso products. This is done by the Nespresso Academy. Membership is given to resellers, who are then intensively trained on the Nespresso approach and learn how to represent the brand best. Furthermore, the Academy is a worldwide network for mutual exchange between distribution partners, who aim to continuously improve the concept and support learning. Every registered Nespresso customer is a member of the Nespresso Club, which currently has around ten million members. In order to place orders online and receive services included in membership, customers must register with Nespresso and provide relevant personal

data. This allows the company to build up customer profiles and conduct individualized marketing activities. Word-of-mouth advertising is the club's biggest strength as 50 percent of new members are acquired through existing members (IIBD, 2015; Nespresso, 2013). The main customer benefit of club membership is emotional; it involves feeling a sense of belonging to a special network. To foster customers' personal connections to the brand, Nespresso continually organizes special sports and lifestyle events for club members, or grants certain privileges to them (Nespresso, 2014f, 2014h). One of the privileges of club membership in 2005 was participating in choosing George Clooney as the new candidate for celebrity endorsement (Nespresso, 2014i).

Besides the Nespresso machines, capsules, retail boutiques, and club membership, advertising is another element that contributes to the Nespresso strategy. George Clooney and Penélope Cruz promote the brand as testimonials; they personify the exquisite, successful, and aspirational lifestyle that Nespresso wants to portray (Figure 1).

From a difficult start to tremendous growth – the history of Nespresso

Nespresso's market approach has not always been successful. It took Nespresso more than ten years to develop its fruitful product (Markides and Oyon, 2000). The first patents for the innovative coffee preparation system were developed in the 1970s. Back then, Nespresso was still under the umbrella of the Nestlé group. In 1986, Nestlé actually founded the Nespresso SA. The company first tried to enter the market for restaurants and office coffeemakers. This attempt, however, was ineffective and almost put the company out of business. The firm believed that once people tried Nespresso at their office, they would buy a machine for their home. However, this strategy did not work. In 1988, Jean-Paul Gaillard joined Nestlé highly motivated to join the Nespresso unit and save the project from crisis. As Commercial Director and later CEO of Nespresso, he introduced the strategy that eventually brought enormous success to the company (Markides and Oyon, 2000).

Nestlé has been successful in the food industry since 1866, but with Nespresso, the company entered a completely new industry (coffee machines and equipment) in which they had no previous experience. Therefore, during restructuring, Gaillard was driven by the belief that Nespresso had to concentrate on the product (coffee) as the core business activity and outsource production, selling, and all services concerning the machines to selected manufacturers and retailers. During this time, 1,700 patent applications were granted; these patents have since contributed to the large patent stock Nespresso has used to ensure maximum intellectual property protection, and this still pays off today. Nespresso profits significantly from selling its espresso capsules (85 percent gross margin) and additional accessories, but not from selling coffee machines (Matzler *et al.*, 2013). Essentially, Nespresso follows the "bait and hook" business model (Teece, 2010): the company sells coffee machines as cheaply as possible to gain market penetration ("bait the customer"), and then sells proprietary consumable capsules, which generate recurring revenue, at a very high-profit margin; since only Nespresso capsules work in the machine, consumers purchase only Nespresso capsules (the consumer is "hooked").

Moreover, Nespresso focussed on a different target group – private households. Gaillard believed a new product like Nespresso had to be "pushed" on the market because consumers do not realize a need for a new type of product unless they are told. With this belief, he supported the traditional "technology push" view and disregarded market

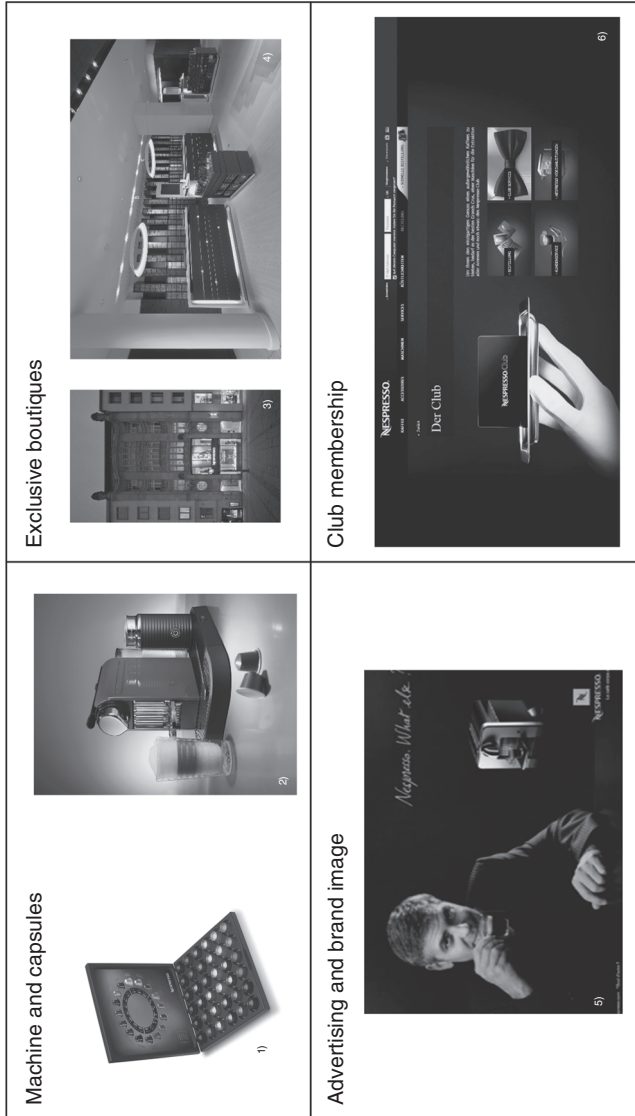


Figure 1.
Overview of the
Nespresso strategy
components

research that had revealed little chance of success for Nespresso. After a period of three months, it became clear his new strategy would be profitable (Markides and Oyon, 2000).

Nestlé Nespresso SA, today still an independently operating company, was founded in 1986 in Lausanne, Switzerland (Nespresso, 2014g) so that Nespresso's own image and strategy (distinct from the parent firm) could be established more easily. Nespresso also developed separate suppliers and policies (human resources and commercial) from the parent firm, and moved headquarters from Nestlé's office in Vevey, to the neighboring community of Pully in Lausanne. From that point on, the company's goals were successfully pursued, and several CEOs have since continued to follow Gaillard's direction: small, independent companies are more flexible and faster to adopt strategies than big organizations.

Nespresso has enjoyed double-digit growth rates every year since 2000, and the number of employees has risen from 331 in the year 2000 to 9,500 in 2013. With a worldwide presence in 60 countries, Nespresso possibly generated sales of \$4.1 billion in 2012 with an overall profit margin around 30 percent (Simonian and Lucas, 2012). An important factor that has considerably boosted Nespresso's success, especially regarding online distribution, is the establishment and booming growth of the internet during the 1990s and since. Buying capsules online is much more convenient than ordering them via telephone. This relatively long time span between the initial development of the Nespresso system and its success shows that, sometimes, innovations need time to pay off and strongly depend on external conditions. Furthermore, if there are no suitable opportunities for application and distribution, even the most technically sophisticated invention might fail.

Is Nespresso really an innovation case?

An invention becomes an innovation when it is successfully commercialized. According to Hauschildt and Salomo (2011) and Vahs and Brem (2013), innovations can be classified based on the following dimensions: trigger, area, change, and novelty.

First, the trigger of the innovation is examined. A "pull induction" indicates the innovation is developed and introduced to the market due to a specific market demand. Such unsatisfied customer needs can, for instance, be identified by market research. On the other hand, instead of consumers "pulling" an innovation to them (so-to-speak), innovations induced by a "push trigger" are "put" on the market independent of respective market needs. "Push" innovations are usually technical novelties for which a customer need has yet to be developed. This is accompanied by the second dimension of innovation, which describes the extent of change. Incremental innovations are characterized by relatively fast realization and little risk. They can be newer versions of an established product and are needed to help the firm stay competitive in the short run. They most likely do not show high-earnings potential compared to radical innovations. Radical innovations are breakthrough changes. In a best case, they create new markets and achieve high growth rates; however, there is also a high risk that no market develops or technological problems and uncertainties arise. Furthermore, innovations can be distinguished as product, process, or service innovations. Finally, the last dimension examines the novelty of the innovation – whether the innovation is new to the world or new to the company.

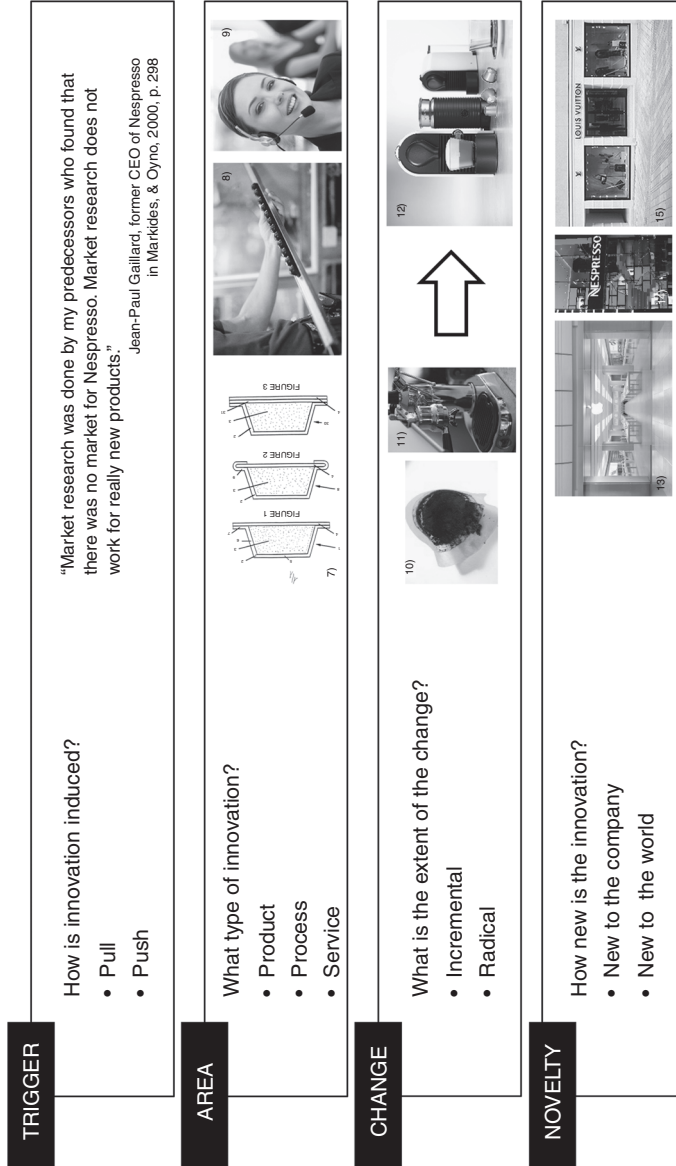
To determine whether Nespresso is an innovation, these dimensions must be applied. Nespresso was "pushed" on the market according to the company's former CEO, Jean-Paul Gaillard, who said: "[...] there was no market for Nespresso [and]

market research cannot work for really new products” (Markides and Oyon, 2000, p. 298). Regarding the type of innovation, the capsules’ manufacturing process and the espresso’s brewing process within the Nespresso machine can be classified as a process innovation. The system electronically holds the water temperature constant within a range of 86-91 degrees Celsius, which was recognized as the optimal temperature. A patented extraction and brewing system, including a 19-bar high-pressure water pump, produces a balanced interaction of pressure, speed, and quantity (Matzler *et al.*, 2013). Furthermore, Nespresso contributes to the area of service innovation concerning the profound service culture in its retail boutiques and over the telephone. The extent of the change from standard coffee machines to the Nespresso concept cannot be clearly determined. On the one hand, it is an incremental change because espresso as a product itself is nothing new. However, Nespresso changed the way espresso is consumed, by making it more comfortable and elegant, and thus giving it a new image. On the other hand, Nespresso introduced a process for producing espresso (Nespresso machine) that was completely new at the time. Therefore, the machine interior, with its technical equipment, represented a radical change. Hence, different views on this evaluation can be argued regarding whether this is an incremental or a radical innovation. Although at the time Nespresso was introduced, Nestlé’s product portfolio included other coffee brands, the Nespresso system managed to reach a unique market position as a luxury lifestyle brand that no other coffee brand had achieved before. Therefore, the novelty of the innovation is defined as new to the world (Figure 2).

Innovation as a source of competitive advantage

The main challenge for companies is to “achieve competitive advantage through acts of innovation” (Porter, 1990, p. 75). Porter further states that using new technologies and doing things differently is necessary to achieve competitive advantage. The resource-based view of the firm emphasizes the importance of a firm’s core competencies (Wernerfelt, 1984). Such competencies have the potential to create a competitive advantage and therefore companies must identify core competencies, how they can make use of them, and the value creation that can be achieved through this process. Additionally, the value, rarity, imitability, organization (VRIO) framework, introduced by Barney (1991), is used by firms to analyze their resources and capabilities to determine if the firm has a competitive advantage. Regarding the VRIO framework, a valuable resource/capability enables the firm to implement strategies that improve efficiency and effectiveness, and allows the company to exploit opportunities or neutralize external threats. A resource/capability is considered rare if the number of firms that possess it is less than the number of firms needed to generate perfect competition dynamics. Resources/capabilities that cannot be imitated are created from unique historical conditions, social complexity in a company, and/or casual ambiguity. Finally, regarding the VRIO framework, the organization aspect refers to whether the company is organized, ready, and able to exploit the resource/capability. Strategic success also depends on strategic leadership with clear communication of the company’s vision, successful alignment of the strategy, and the ability to change the approach. Therefore, managers with high leadership competence can be a powerful core competency as well (Figure 3).

Regarding the VRIO framework, with respect to Nespresso, the company’s core competencies are valuable resources in the form of new product and process technologies that enhance an effective and efficient strategy (Grant, 2013).



Sources: Adapted and translated from Vahs and Brem (2013, p. 52)

Figure 2.
Dimensions of innovation using the Nespresso example

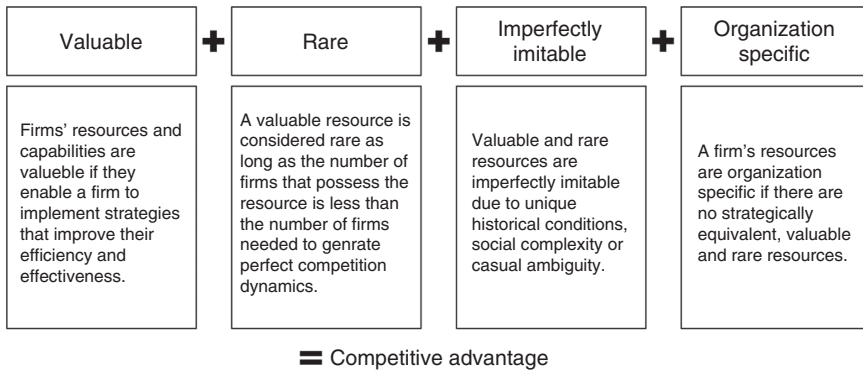


Figure 3.
Core competencies as sources of competitive advantage: VRIO framework

Source: Derived from Barney (1991)

Furthermore, Nespresso's resources/capabilities are rare because the company holds over 1,700 patents that protect the company's products (Alich, 2013), processes, and brand. Moreover, Nespresso's advertising strategy to position the company as a luxury, aspirational lifestyle brand, with George Clooney and Penélope Cruz as spokespeople, contributes to its uniqueness. Next, Nespresso is difficult to imitate because brand reputation and strong customer relationships are historically grown. In addition, the premium service culture is intensively embedded in the employees and is therefore socially complex (Markides and Oyon, 2000; Matzler *et al.*, 2013; Nespresso, 2014h). Another interesting consideration is Nespresso's causal ambiguity. It is not clear which attribute most attracts people to Nespresso: is it the high quality of the coffee, the service, the advertising, the aspirational lifestyle image, or a completely different feature – or a combination of attributes? This unknown makes it even more difficult to imitate Nespresso. Finally, concerning organizational specificity, it is hard to make a statement at this point in time. Obviously, Nespresso has been organized being ready and able to exploit its resources and capabilities. However, the company's resources/capabilities will prove to be organization specific only if they are sustainable in the long run, and no strategic equivalent appears in the market. It is also important to note that Nespresso has had outstanding CEOs and managers. The company's committed leaders, starting with Gaillard, aligned Nespresso's strategy and market position with its intended brand image. Successful leadership principles from Gaillard and others have been firmly anchored in the company's operations, and this has become a powerful and valuable resource. Summarizing, these core competencies form the competitive advantage Nespresso has achieved. However, some recent developments have taken place that challenge Nespresso's competitive advantage (Figure 4).

How sustainable is the innovation and the competitive advantage?

Until now, Nespresso's business model has shown a high level of value creation (Matzler *et al.*, 2013). However, the future is less certain with the expiry of strategically important patents. Nespresso's intellectual property for many parts of its system is no longer protected; the patents have either already expired or will soon do so. This has led to its market share decreasing from 32 percent in 2010 to 27 percent today (Revill, 2012). Especially, the expiration of its capsule patents has led to a high number of imitators that have been penetrating the market and offering a massive range of

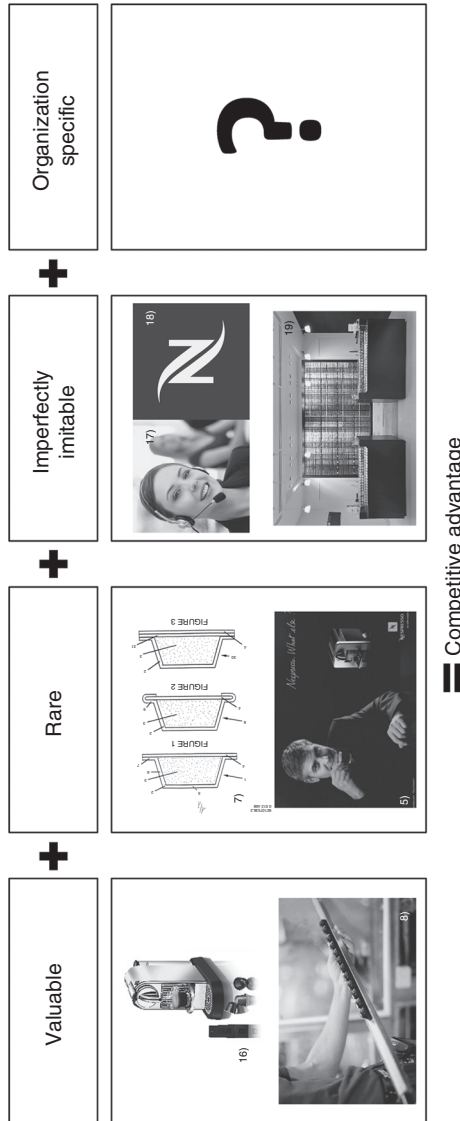


Figure 4.
VRIO framework
using the example
of Nespresso

capsules compatible to Nespresso machines (Revill, 2012). Unlike the original Nespresso capsules, imitator capsules can be purchased in a variety of retail stores and at a lower price. Customers who do not attach value to buying high-quality espresso capsules in Nespresso's stylish retail boutiques may see value in the convenience of buying lower priced espresso capsules in common grocery stores. These factors make imitator capsules real substitutes for Nespresso products. Imitator capsules are being made by regional brands in many countries, such as Denner in Switzerland Rewe in Germany, and Walmart in the USA.

Minges, a trademark specialist, also joined the queue of Nespresso imitators. The firm became famous in 2006 when it won a case against Senseo (a former subsidiary of Philips), which offers another approach to serving coffee through a coffee pad system. This court decision made it possible to copy the pad system, which was introduced by Senseo (Chwallek, 2013b). Moreover, Mondelez International Inc., the third largest food producer worldwide after Nestlé and PepsiCo, announced its intention to launch capsules suitable for the Nespresso system. In Europe alone, the company is already facing competition from many imitator capsules (Boyle, 2013) and so far, competitors have been able to realize the requirements for successful imitation. First, they recognized the capsule business is something worth imitating; and second, they showed willingness to copy it. It remains unclear whether any competitors will also be able to develop the relevant resources to copy Nespresso's entire business model. Nespresso has been fighting competition and the company has pursued several deterrence strategies. For instance, the company filed lawsuits to force imitators to sell their capsules with a disclaimer that they are not compatible with the Nespresso system; however, the court dismissed the claim (Revill, 2012; Lebensmittel Zeitung, 2013). As a follow-up action, Nespresso slightly changed the piercing mechanism for capsules in three new versions of Nespresso machines to obviously prevent some imitator products from being used in the machines, and the company explained the change as necessary to optimize the brewing system; however, consumers criticized these changes (Rotzinger, 2013).

Criticism against Nespresso also comes from external stakeholders; the company has to cope with ongoing discussions regarding potential ecological damage from its aluminum capsules. For example, in Germany, one of the biggest growth markets for Nespresso, it is estimated that two billion coffee capsules (from all manufacturers) will be sold in 2014 (Nicolai, 2014a). Hence, Nespresso significantly contributes to about 4,000 tons of aluminum and plastic garbage in Germany alone (Nicolai, 2014b); worldwide this accounts for 1.6 million tons per year (Ehrenfried, 2013). Although a return system for used capsules has been set up to counter the accusation of environmental pollution, it does not solve the problem because customers do not sufficiently take advantage of the 20,000 collecting points worldwide. In Switzerland, Nespresso offers an even more convenient way for customers to recycle their capsules: the postal workers collect them free of charge. The solution to this issue specifically in the German market is the national packaging recovery system "Grüner Punkt," which releases manufacturers from the obligation to take back used packaging in return for a license fee (Der grüne Punkt, 2015; Ehrenfried 2013). Therefore, here the consumers' self-responsibility is required to sort their waste and have it recycled accordingly. Even though there exist ways of handling the waste issue, the big problem of the Nespresso waste is just the enormous scale of aluminum capsules that are sold, used and thrown away each minute (Ehrenfried, 2013). Although Nespresso is not the only coffee system dealing with environmental issues (Tchibo and Tassimo systems also produce plastic and aluminum waste), Nespresso's fancy aluminum capsule is

already an important element of the company's exclusive image and brand strategy. Therefore, the firm needs a convincing justification concerning the further use of aluminum. Nespresso states that no other tested material fulfills the quality criteria to properly store high-quality espresso (Nicolai, 2013).

Against the background of increasing competitive pressure and public criticism regarding environmental issues, it is most interestingly that the former CEO and founder of the initial Nespresso strategy, Jean-Paul Gaillard, has become a Nespresso competitor himself. His company (Ethical Coffee Company, 2014) sells capsules compatible with the Nespresso system that are cheaper than Nespresso's, and above all, are completely biodegradable (Doherty, 2012; Ethical Coffee Company, 2014). A further effort toward a more sustainable image, although not related to the packaging problem, is Nespresso's commitment to the Nespresso AAA sustainable quality program (Matzler *et al.*, 2013). Started in 2003, the program aims for sustainable growth of high-quality coffee by involving over 60,000 farmers in eight countries: Costa Rica, Colombia, Guatemala, Mexico, India, Nicaragua, Ethiopia, and Brazil. Through the assessment and improvement of the sustainability practices of coffee farmers, and by paying the farmers a premium price, Nespresso has become one of the first global beverage companies to highlight the social and environmental dimensions of its supply chain (Alvarez *et al.*, 2010).

Along with fighting external competition, Nespresso's parent firm, Nestlé, also has shown an increasing tendency to develop new business models. With Dolce Gusto by Nescafé, Nestlé has become a competitor to Nespresso; the capsules are available from several retailers and are priced similar to other imitator products. Currently, a Dolce Gusto capsule costs \$0.38 on average, vs a Nespresso capsule at \$0.57 on average. However, Dolce Gusto does not intend to provide capsules compatible with the Nespresso system. With Nespresso and Dolce Gusto, Nestlé commands a 75 percent market share in Europe with double-digit growth rates (Nicolai, 2014a). In addition, there is competition from other Nestle-owned products like Dallmayr Coffee (Nestlé owns 25 percent), which will introduce a capsule system at a lower price (\$0.32 per capsule). Overall numbers about imitator capsules differ from 50 (Boyle, 2013) and 60 (Nicolai, 2014c), up to 140, a number provided by Nespresso itself.

Further evidence of the precarious competitive situation is "Special T," a premium portioned specialty tea capsule system created and launched by Nestlé. The system's automated "tea machines" function with tea-packed capsules similar to the aforementioned coffee systems. Moreover, Special T's high-quality image, variety of teas and accessories, and online product distribution shows an attempt to replicate the Nespresso strategy (Special Tea, 2014). It remains to be seen whether Nestlé's Special T can build on the success of Nespresso in the tea segment.

Apart from the challenges already mentioned, Nespresso has to cope with succession issues: in March 2013, Jean-Marc Duvoisin replaced Richard Girardot as CEO. Changing top management always involves risk, especially when businesses must create an environment where innovations develop and bear fruit (Markides and Oyon, 2000). Hence, due to various challenges, Nespresso's competitive advantage has been jeopardized and it is up to the new CEO to implement strategic actions to sustain Nespresso's competitive advantage for the long term. Against this background, it is often argued the only real harm to Nespresso would be an imitation of the company's entire business model, which is still regarded as non-duplicable (Matzler *et al.*, 2013). Jean-Marc Duvoisin agrees with that opinion and points out: success ultimately depends on product quality. Nevertheless, few companies have ever sustained long-term competitive advantage by resting on their laurels.

References

- Alich, H. (2013), "Nestlé contra Mondelez: Nespresso plays a trump in the quarrel over capsules", *Handelsblatt*, available at: www.handelsblatt.com/unternehmen/handel-dienstleister/nestle-kontra-mondelez-nespresso-zieht-einen-trumpf-im-kapsel-zank-seite-all/9170030-all.html (accessed January 15, 2014).
- Alvarez, G., Pilbeam, C. and Wilding, R. (2010), "Nestle's Nespresso AAA sustainable quality program: an investigation into the governance dynamics in a multi-stakeholder supply chain network", *Supply Chain Management: An International Journal*, Vol. 15 No. 2, pp. 165-182.
- Barney, J. (1991), "Firm resources and sustained competitive advantage", *Journal of Management*, Vol. 17 No. 1, pp. 99-120.
- Boyle, M. (2013), "Nestle's Nespresso to face new Mondelez copycat capsule", *Bloomberg*, available at: www.bloomberg.com/news/2013-06-10/nestle-s-nespresso-to-face-new-copycat-capsule-from-mondelez.html (accessed January 10, 2014).
- Chwallek, A. (2013a), "Attacke gegen Nespresso", *Lebensmittel Zeitung*, No. 24, p. 2.
- Chwallek, A. (2013b), "Minges kommt mit Nespresso-Kapseln", *Lebensmittel Zeitung*, No. 38, p. 12.
- Der grüne Punkt (2015), "Innovationstreiber für Rücknahmelösungen", available at: www.gruener-punkt.de/de/verbraucher/unternehmen.html (accessed February 17, 2015).
- Doherty, D. (2012), "Nespresso to face competition on machines from ethical coffee", *Bloomberg*, available at: www.bloomberg.com/news/2012-12-03/nespresso-to-face-competition-on-machines-from-ethical-coffee.html (accessed January 15, 2014).
- Ehrenfried, F. (2013), "Frage der Woche: Wie schädlich ist der Kaffee aus der Kapsel", *Wirtschaftswoche Green*, available at: <http://green.wiwo.de/frage-der-woche-wie-grun-ist-der-kaffee-aus-der-kapsel/> (accessed February 17, 2015).
- Ethical Coffee Company (2014), "A biodegradable capsule", available at: www.ethicalcoffeecompany.com/ (accessed February 2, 2014).
- Grant, R.M. (2013), *Contemporary Strategy Analysis: Text and Cases*, John Wiley & Sons, Chichester.
- Hauschildt, J. and Salomo, S. (2011), *Innovationsmanagement*, Vahlen, Munich.
- Hungenberg, H. (2012), *Strategisches Management in Unternehmen*, Gabler Verlag, Wiesbaden.
- IIBD (2015), "Strategy Newsletter: Differentiating a Commodity Volume 12 Letter 8", available at: www.iibd.com/news/?action=viewone&newsid=160 (accessed February 20, 2015).
- Jones, D. (2013), "Travel came before computers and coffee", *Travel Trade Gazette UK & Ireland*, No. 3050, p. 21.
- Lebensmittel Zeitung (2013), "Nespresso darf sich nicht abkapseln", *Lebensmittel Zeitung*, No. 9, p. 30.
- Liganova (2014), "Nespresso: Manish Arora Schaufenster & Instore Kampagne", available at: www.liganova.com/de/kundenubersicht/nespresso/nespresso-manish-arora-for-nespresso (accessed December 29, 2014).
- Markides, C. and Oyon, D. (2000), "Changing the strategy at Nespresso: an interview with former CEO Jean-Paul Gaillard", *European Management Journal*, Vol. 18 No. 3, pp. 296-301.
- Matzler, K., Bailom, F., von den Eichen, S.F. and Kohler, T. (2013), "Business model innovation: coffee triumphs for Nespresso", *Journal of Business Strategy*, Vol. 34 No. 2, pp. 30-37.
- Nespresso (2013), "Key performance indicators", available at: www.google.de/url?sa=t&rct=j&q=&esrc=s&source=web&cd=10&cad=rja&uact=8&ved=0CGwQFj&url=http%3A%2F%2Fwww.nestle-nespresso.com%2Fasset-libraries%2FDocuments%2FNespresso%2520-%2520Key%2520Performance%2520Indicators%2520Factsheet.pdf&ei=xermVKHVVH43APLqygKAN&usq=AFQjCNGwPIMJ_e0sB2CQxsbpIEveCfrjOA&sig2=gi7-DE2sZNNgJILfNdxnmw (accessed February 20, 2015).

- Nespresso (2014a), "Coffee at Nespresso: the journey to perfection", available at: www.nespresso.com/de/en/coffee-expertise.html (accessed December 29, 2014).
- Nespresso (2014b), "Nespresso accessories", available at: www.nespresso.com/de/en/products/accessories/collections-3404.html (accessed December 29, 2014).
- Nespresso (2014c), "Our company", available at: www.nestle-nespresso.com/about-us/our-company (accessed January 10, 2014).
- Nespresso (2014d), "Our history: phase 3", available at: [www.nestle-nespresso.com/about-us/our-history/#Phase_Phase 3](http://www.nestle-nespresso.com/about-us/our-history/#Phase_Phase%203) (accessed January 10, 2014).
- Nespresso (2014e), "Magazine", available at: www.nespresso.com/magazine/gb/en/article/1/980/now-design.html (accessed January 10, 2014).
- Nespresso (2014f), "Facts and figures", available at: www.nestle-nespresso.com/about-us/facts-and-figures (accessed January 10, 2014).
- Nespresso (2014g), "Our history", available at: www.nestle-nespresso.com/about-us/our-history (accessed January 10, 2014).
- Nespresso (2014h), "Our people", available at: www.nestle-nespresso.com/about-us/our-people (accessed 10 January 2014).
- Nespresso (2014i), "Brand related", available at: www.nestle-nespresso.com/about-us/faqs/brand-related (accessed January 10, 2014).
- Nespresso (2015), "Gourmet", available at: www.nespresso.com/de/en/products/gourmet.html (accessed February 17, 2015).
- Nestlé (2014), "Marken: Nespresso", available at: www.nestle-marktplatz.de/view/Marken/Nespresso (accessed December 29, 2014).
- Nicolai, B. (2013), "Tchibo zieht in den Kapsel-Krieg gegen Nespresso", *Die Welt*, available at: www.welt.de/wirtschaft/article112328246/Tchibo-zieht-in-den-Kapsel-Krieg-gegen-Nespresso.html (accessed January 10, 2014).
- Nicolai, B. (2014a), "Nestlé eröffnet gigantische Kapsel-Fabrik in Schwerin", *Die Welt*, available at: www.welt.de/wirtschaft/article131948435/Nestle-eroeffnet-gigantische-Kapsel-Fabrik-in-Schwerin.html (accessed January 10, 2014).
- Nicolai, B. (2014b), "4000 Tonnen Müll durch Kaffeekapseln in Deutschland", *Die Welt*, available at: www.welt.de/print/die_welt/wirtschaft/article123682807/4000-Tonnen-Muell-durch-Kaffeekapseln-in-Deutschland.html (accessed January 10, 2014).
- Nicolai, B. (2014c), "Angriff der Verwandtschaft", *Die Welt*, available at: www.welt.de/print/die_welt/wirtschaft/article128240565/Angriff-der-Verwandtschaft.html (accessed January 10, 2014).
- Porter, M.E. (1990), "The competitive advantage of nations", *Harvard Business Review*, Vol. 68 No. 2, pp. 73-93.
- Reuters (2012), "Kaffeekapseln lassen Nestle-Umsatz steigen", *Handelsblatt*, available at: www.handelsblatt.com/unternehmen/industrie/lebensmittelkonzern-kaffeekapseln-lassen-nestle-umsatz-steigen/6533202.html (accessed January 10, 2014).
- Revell, J. (2012), "Nespresso reshuffles as rivals wade in", *The Wall Street Journal*, available at: <http://online.wsj.com/news/articles/SB10001424127887324352004578132943986605034?mg=reno64-wsj&url=http%3A%2Fonline.wsj.com%2Farticle%2FSB10001424127887324352004578132943986605034.html> (accessed January 10, 2014).
- Rotzinger, U. (2013), "Nespresso baut eine Kaffeemaschine, die Klon-Kapseln zerstört: Das Imperium schlägt zurück", available at: www.blick.ch/news/wirtschaft/das-imperium-schlaegt-zurueck-id2556050.html (accessed January 10, 2014).
- Simonian, H. and Lucas, L. (2014), "Starbucks takes coffee wars to Nespresso", available at: www.ft.com/cms/s/0/d90109a4-66ec-11e1-9e53-00144feabdc0.html (accessed December 8, 2015).

- Special Tea (2014), “Home”, available at: http://de.special-t.com/spt_de_de/ (accessed January 12, 2014).
- Teece, D. (2010), “Business models, business strategy and innovation”, *Long Range Planning*, Vol. 43 Nos 2-3, pp. 172-194.
- Vahs, D. and Brem, A. (2013), *Innovations Management. Von der Idee zur erfolgreichen Vermarktung*, Schäffer-Poeschel, Stuttgart.
- Wernerfelt, B. (1984), “A resource-based view of the firm”, *Strategic Management Journal*, Vol. 5 No. 2, pp. 171-180.

Photo credits

- 1), 2), 3), 4), 8), 9), 12), 14), 16), 18), 19), available at: www.nestle-nespresso.com/media/library/pictures (accessed October 14, 2014).
- 5): available at: www.google.de/imgres?imgurl=http%3A%2F%2Fstatic5.businessinsider.com%2Fimage%2F4f208c9beab8ea644300017%2Fgeorge-clooney-cusses-out-his-coffee-commercial-critics.jpg&imgrefurl=http%3A%2F%2Fwww.businessinsider.com%2Fgeorge-clooney-says-f-you-to-his-coffee-commercial-critics-2012-1&h=300&w=400&tbnid=GFEZFrVfbvPb6M%3A&zoom=1&docid=8_vRD2CZYzT0mUM&ei=VUU9VPSXI6TN7QbFsIDACA&tbn=isch&iact=rc&uact=3&dur=6997&page=1&start=0&ndsp=29&ved=0CCgQrQMwAg (accessed October 14, 2014).
- 6): Screenshot of available at: www.nespresso.com/de/de/pages/the-nespresso-club (accessed October 14, 2014).
- 7): German/European Patent No. DE 692 17 113.4/EP 92 10 7536.2.
- 11): available at: http://upload.wikimedia.org/wikipedia/commons/8/8b/Europiccola_-_La_Pavoni.jpg (By Mark_Whatmough (Close up of Group Head) [CC-BY-2.0 (<http://creativecommons.org/licenses/by/2.0/>)], via Wikimedia Commons) (accessed October 14, 2014).
- 10): available at: http://commons.wikimedia.org/wiki/File:Coffee_Filter_2006_09_09.JPG#mediaviewer/File:Coffee_Filter_2006_09_09.JPG (By—Estormiz 06:57, 10 September 2006 (UTC) (Own work) [Public domain], via Wikimedia Commons) (accessed October 14, 2014).
- 13): available at: www.apple.com/de/retail/sindelfingen/ (accessed October 15, 2014).
- 15): available at: <http://de.louisvuitton.com/deu-de/geschafft/germany/louis-vuitton-nurnberg> (accessed October 15, 2014).
- 17): available at: https://c2.staticflickr.com/6/5523/9160573259_5bf835c0d4.jpg (by RaHuL Rodriguez, photo taken at 28th of June 2013) (accessed October 15, 2014).

Appendix

Questions for case discussion (in a separate file in addition to the case for lecturers)

Definition of innovation:

- (1) Is Nespresso an example of innovation? Why?
- (2) How would you evaluate Nespresso in terms of the four dimensions of innovation?
- (3) What are the prerequisites that a new product must fulfill to repeat Nespresso’s success?
- (4) How would you evaluate the product innovation “Special T” and explain challenges related to the current lack of success of Nestlé’s tea concept?

Competitive advantage:

- (1) Against the background of the VRIO framework, do you agree with the case’s assessment of Nespresso? What is your opinion regarding the organization specificity of Nespresso’s competitive advantage?

- (2) Imagine that you are the new CEO of Nespresso. What strategic steps would you take to overcome competition while sustaining your competitive advantage?
- (3) Considering Nespresso's core competences, which new markets and business models would you suggest to explore?
- (4) Recently Nespresso added new building blocks to its business model, like a Nespresso system for commercial airplanes or the new machine and capsule system "VertuoLine." How do you interpret these developments within Nespresso's business model?

Further recommended reading for case discussion

- Barney, J. (1991), "Firm resources and sustained competitive advantage", *Journal of Management*, Vol. 17 No. 1, pp. 99-120.
- Barney, J.B., Ketchen, D.J. and Wright, M. (2011), "The future of resource-based theory: revitalization or decline?", *Journal of Management*, Vol. 37 No. 5, pp. 1299-1315.
- Brem, A. (2011), "Linking innovation and entrepreneurship – literature overview and introduction of a process-oriented framework", *International Journal of Entrepreneurship and Innovation Management*, Vol. 14 No. 1, pp. 6-35.
- Brem, A. and Voigt, K.-I. (2009), "Integration of market pull and technology push in the corporate front end and innovation management – insights from the German software industry", *Technovation*, Vol. 29 No. 5, pp. 351-367.
- Kraaijenbrink, J., Spender, J.C. and Groen, A.J. (2010), "The resource-based view: a review and assessment of its critiques", *Journal of Management*, Vol. 36 No. 1, pp. 349-372.
- Makhija, M. (2003), "Comparing the resource-based and market-based views of the firm: empirical evidence from Czech privatization", *Strategic Management Journal*, Vol. 24 No. 5, pp. 433-451.
- Teece, D. (2010), "Business models, business strategy and innovation", *Long Range Planning*, Vol. 43 Nos 2-3, pp. 172-194.

Corresponding author

Professor Alexander Brem can be contacted at: brem@mci.sdu.dk