



CATÓLICA
LISBON
BUSINESS & ECONOMICS

INCREASING THE GAP: HOW NESCAFÉ DOLCE GUSTO STRIVED IN A HOSTILE COMPETITIVE ENVIRONMENT

João Miguel Moreira Lamarão

Supervisor: Paulo Gonçalves Marcos

Dissertation submitted in partial fulfillment of requirements for the degree of MSc in
Business Administration, at the Universidade Católica Portuguesa, June 2015.

Abstract

Title: Increasing the gap: How Nescafé Dolce Gusto strived in a hostile competitive environment

Author: João Miguel Moreira Lamarão

As part of the Nestlé Group, Nescafé Dolce Gusto was launched in Portugal in 2007 aiming to democratize an entire market segment exclusively owned by Nespresso until then: coffee capsules. Five years of successes later, António Sousa, the brand's marketing manager, was faced with a few challenging circumstances which inevitably he had to address. He was witnessing an industry that never stopped growing year after year. Unfortunately, Nescafé Dolce Gusto was not alone driving this growth, as other players began surfacing and claiming their spot. The business environment had become aggressively competitive and resorting to sales promotions was revealing itself as a quick way to stay relevant, yet at the cost of profitability. Nonetheless, recovering market share lost to the main competitors was the key objective for 2012. Recent tax policy changes due to the economic crisis caused Nescafé Dolce Gusto to become the only brand selling a standard capsules pack at a price point above €5. António knew he had to start from there if he was to achieve the proposed targets. Surprisingly, he found out the solution could in fact be to develop a new promotional pack, differently sized and priced than the regular 16 capsules pack offered. At the end of the day, he had to choose between going for a 12 capsules pack or a 30 capsules pack, and this decision could be the most important he made in years.

Resumo

Título: Aumentando o gap: Como a Nescafé Dolce Gusto lutou num ambiente competitivo hostil

Autor: João Miguel Moreira Lamarão

Como parte do Grupo Nestlé, a Nescafé Dolce Gusto foi lançada em Portugal em 2007 com o intuito de democratizar um segmento de mercado detido na totalidade pela Nespresso até então: o café em cápsulas. Cinco anos de sucessos depois, António Sousa, o gestor de marketing da marca, foi confrontado com algumas circunstâncias desafiantes, as quais ele teria inevitavelmente de abordar. Assistia a uma indústria que não parava de crescer ano após ano. Infelizmente, a Nescafé Dolce Gusto não estava sozinha neste crescimento à medida que outros *players* começavam a surgir e a tomar o seu lugar. O enquadramento empresarial tinha-se tornado agressivamente competitivo e recorrer à promoção de vendas era uma maneira rápida de tornar as marcas relevantes, a custo da rentabilidade. No entanto, recuperar a quota de mercado perdida para os principais concorrentes era o grande objetivo para 2012. Uma mudança recente na política de impostos devido à crise económica fez com que a Nescafé Dolce Gusto se tornasse na única marca com um pacote *standard* de cápsulas acima da barreira dos €5. António sabia que teria de começar por aí se ia cumprir as metas propostas. Surpreendentemente, descobriu que a solução poderia estar no desenvolvimento de um novo pacote promocional, de dimensão e preço diferentes em comparação com o pacote de 16 cápsulas regular. A decisão final era escolher entre um pacote de 12 cápsulas ou um de 30 cápsulas, e essa decisão poderia ser a mais importante que ele iria tomar nos últimos anos.

Acknowledgements

First of all I would like to thank my family for always supporting me throughout life and helping me reach this far. Writing this dissertation would not have been possible without my father, my mother, my sister and my grandparents. I also thank my friends for bearing with me through this journey and relentlessly motivating me.

I express my deepest gratitude to Marta Batista. Thank you for being there when I needed the most, for providing unmeasurable advice, for inspiring me every day and for encouraging me to never give up.

A special thanks to Teresa Mendes, Nescafé Dolce Gusto's current marketing manager, for all the invaluable information provided and availability towards myself and this dissertation, as well as to Manuela Esteves and Patrícia Ventura for guiding and supporting me for the past year. Likewise, I thank all my other work colleagues who frequently incentivized me.

At last, I genuinely recognize the essential involvement and guidance given by Prof. Paulo Marcos during this process, along with all other professors I encountered in the course of both my bachelor and master's degrees who still inspire me to this day.

Table of Contents

Abstract.....	I
Resumo	I
Acknowledgements	II
Case Study	5
Introduction.....	5
The Portuguese FMCG situation	6
Ongoing crisis	6
Sales promotion as the main driver	7
The Company.....	8
Nestlé S.A.....	8
Nestlé Portugal S.A.	8
Nespresso	9
Nescafé.....	11
Nescafé Dolce Gusto	11
The Coffee Industry	13
In the World	13
In Portugal	13
The Single-serve Coffee Industry	14
In the world	14
In Portugal	15
First steps, from 2007 to 2010	16
Buondi & Sical in capsules, fighting local with local.....	18
Present day – was sales promotion the answer?	19
Conclusion	22
Exhibits.....	23
Exhibit 1 Portugal Top Coffee Capsules Brands	23
Exhibit 2 Competitors Capsules and Machines Portfolio	23
Exhibit 3 NDG Machines 2007 Portfolio	26
Exhibit 4 NDG Capsules 2007 Portfolio	26
Exhibit 5 World Top Coffee Producers	27
Exhibit 6 World Coffee Consumption per capita	27
Exhibit 7 World Top Coffee Companies	28
Exhibit 8 Portugal Top Coffee Companies	29
Exhibit 9 Coffee Capsules Top 10 Countries	29

Exhibit 10	World Top Coffee Capsules Companies.....	29
Exhibit 11	Portugal Top Coffee Capsule Machines Brands	30
Exhibit 12	NDG Path to Purchase Perspective	30
Exhibit 13	NDG Marketing and Trade Activities 2007-2010	31
Exhibit 14	NDG Current Machines Portfolio	33
Exhibit 15	NDG Current Capsules Portfolio	34
Exhibit 16	NDG Capsules Sales Rankings	35
Exhibit 17	NDG 12 and 30 Capsules Packs	35
Literature Review	.....	36
Teaching Note.....	.....	37
Synopsis .....	.....	37
Suggested Assignment Questions .....	.....	39
Teaching Objectives .....	.....	39
Use of the Case .....	.....	40
Relevant Theory.....	.....	40
Analysis and Discussion .....	.....	42
TN Exhibits .....	.....	54
References .....	.....	56

Case Study¹

Introduction

It was a rainy Friday morning of April, the rainiest of the year so far, and as long as António Sousa² could remember. He was Nescafé Dolce Gusto's marketing manager for the Portuguese market, a coffee capsule system brand owned by the Nestlé Group, and one of the latter's most important brands in terms of sales revenue³. It seemed like the rain served as an irony for the decisions António had to make later that day. He was witnessing one of Portugal's most dynamic industries, as it was still growing at an impressive rate and every year a handful of new players would appear in the market. Something remarkable, considering only ten years ago there was a single brand operating its coffee capsule monopoly, Nespresso. While working in such a marketplace was extremely rewarding, it could easily become somewhat of a headache.

So much had changed since Nescafé Dolce Gusto's arrival in 2007 to the country, especially in the fast-moving consumer goods industry. These days, promotions were one of the few strategies to truly make a brand grow in sales, especially in the single-serve coffee segment. António did not expect five years ago the level of investment his brand would have to make in order to assure a minimum level of sustainable growth. At the same time, retailer brands were continuing to increase their market shares in nearly every product category, and while this was not true in coffee capsules many years ago, it was now. The everyday low price positioning was tremendously difficult to match.

The challenge for 2012 was to take a significant step towards recovering the market share lost in the past, in other words, to increase the gap between Nescafé Dolce Gusto and its competitors. António recently had found out the solution could actually be related to a sales promotion tactic, which again was ironic. Part of the strategy being drawn to fill this gap incorporated a new promotional capsules pack, one that would exponentially increase sales. Essentially it meant deciding between launching a smaller or a larger pack. He had a meeting with his team scheduled for after lunch, and there were

¹ This case was written during 2014/15 however, it depicts events occurred during 2012 and before.

² António Sousa is a fictional character created for the purpose of this case story.

³ Source: Nestlé internal data.

still five hours to go. He grew impatient and anxiously started to organize his ideas to later present them.

The Portuguese FMCG⁴ situation

Ongoing crisis

2011 was yet another year to be filled with crisis related news headlines, and Portugal was probably one of the most talked about countries in Europe regarding this harsh tendency. As the list of worst performers in the continent was disclosed, the Portuguese witnessed an unsurprising 2nd place, only being beaten by the Greeks⁵. The feeling was legitimate, as more than 85% of the population admitted to feel an immediate effect of the economic crisis. Half even described this impact as extremely significant⁶. This climate had clear repercussions on purchasing power, which reached the lowest point in 27 years⁷, as prices increased, wages stayed flat or decreased, and consumption levels were affected for all kinds of industries.

Indeed, these circumstances had even higher consequences on Portugal's FMCG setting. The shopper's⁸ behavior reflected this trend: more buying frequency with less spending per act of purchase, while increasingly preferring the large retail areas, as opposed to traditional ones, and consequently investing more and more on retailers' own-brands⁹. According to Kantar Worldpanel, these brands would achieve a historic 37% market share in FMCG product categories (fresh products excluded) in 2011. To validate this preference, a study by Deco revealed that by choosing retailer brands instead of manufacturer brands, shoppers achieved up to 30% in savings¹⁰. Furthermore, circumstances were aggravated by a 10% increase in VAT, a measure implemented by the government in the beginning of the year. Due to this adjustment, an average expenditure increment of up to 17 euros annually per household was predicted, in a

⁴ Fast-moving consumer goods.

⁵ Source: Jornal de Notícias online (2011).

⁶ Source: Diário de Notícias online (2011).

⁷ Source: Económico online (2011).

⁸ The concept of shopper is defined as the individual who makes in-store purchase decisions.

⁹ Source: Marketeer online (2011).

¹⁰ Source: Hipersuper online (2011).

FMCG context¹¹. A 0.2% negative growth in industry volume between 2010 and 2011¹² was a consequence of the inflation.

Sales promotion as the main driver

The number of sales promotion activities in FMCG rose significantly since the beginning of the economic crisis, with levels of investment coming to more than 4.7 billion euros¹³. In addition, a global study by Simon-Kucher & Partner's¹⁴ in 2011, exposed a market share addicted industry, driven by constant price reductions, which then leads to drops in margins and consequently loss of money. In the study, the interviewed managers acknowledged that 3 out of 4 promotional activities planned by them had a negative return on investment.

Surely, in the context of crisis low prices and promotions were mandatory to survive. Portuguese shoppers were increasingly price aware, rational and demanding regarding their decisions. They were revealed to have great price notions and awareness and being considerably promotion-driven in their shopping behavior, pointing to the fact that for them a store that offered promotions was not a differentiating attribute, but something that was already expected¹⁵. Perhaps one of the most notable events in Portugal's recent sales promotions history was the special Worker's Day promotion carried out at Pingo Doce's¹⁶ stores. On May 1st 2012 shoppers who purchased over €100 worth of goods were offered 50% discount over the total spending. Due to the highly aggressive rebate, some stores were so crowded that they had to close as early as 11 in the morning to avoid putting people's health at risk¹⁷. Such situation undoubtedly portrays a perfect example of an intense and oftentimes hostile FMCG environment.

¹¹ Source: HiperSuper online (2011).

¹² Source: Nielsen Shopper Trends report (2012).

¹³ Source: Marketeer online (2011).

¹⁴ Source: Promotions in the Retail Industry: Study elaborated by Simon-Kucher & Partners in collaboration with Sartia (Extract) (2011).

¹⁵ Source: Nielsen Shopper Trends report (2012).

¹⁶ Pingo Doce was the 2nd largest player in the food retail.

¹⁷ Source: Publico Online (2012).

The Company

Nestlé S.A.

Nestlé S.A was the Swiss multinational behind Nescafé Dolce Gusto (from now on referred as NDG). It was the largest food and beverage company in the world with a sales revenue of 83.6 billion CHF¹⁸ in 2011¹⁹. It had over 333,000 employees spread across more than 150 countries, with almost 500 factories in 86 of them, covering beyond 2,000 different brands as there were nearly 1 billion Nestlé products sold every day. While this dominance was evident, this volume represented only 1.7% of the industry, as the top 20 largest companies make up less than 9% of it. The food and beverages industry was highly segregated, translating in a great number of local players across the globe. In 2011, powdered & liquid beverages, in which coffee was included, was the company's highest revenue generating product category²⁰.

Its origin dated back to 1867, when founder Henri Nestlé, created the first milk-based baby food, *farine lactée* (later known as Cerelac), which saved the lives of numerous children who could not breastfeed at the time. Over the years Nestlé would make several mergers and acquisitions causing the Nestlé Group to comprise highly diversified food and beverage categories. The company famously stated that there is a Nestlé product for each moment of the day. Its mission was to be recognized as the leader in Nutrition, Health and Wellness.

Nestlé Portugal S.A.

Nestlé Portugal was born in 1923 when Professor Egas Moniz (Nobel Medicine Prize in 1949) decided to follow Henri Nestlé's footsteps by establishing the first powdered milk factory in the country, having contributed to reduce the serious infant nutritional deficiencies of the time. This factory was later acquired by Nestlé. In Portugal, the company performed in several business areas, namely infant nutrition, roast and ground coffee, coffee and soluble mixes, chocolate, breakfast cereals, ice cream, mineral

¹⁸ Approximately €78 billion.

¹⁹ Source: Nestlé annual report (2011).

²⁰ Source: Nestlé corporate presentation (2012).

water and pet food, being the leader in most of these categories. The sales revenue in 2012 was 467 million euros, with roughly 20% representing exports²¹. It has over 1,800 employees and four factories.

Nespresso

The player that revolutionized the world coffee industry more than 25 years ago, Nespresso pioneered the premium portioned coffee segment and still remains the reference in it today. In the second half of the 1980's Nespresso SA was created inside the Nestlé Group and it first took a few years before its concept was fully internationally accepted and patented protected. As soon as the company figured out that coffee capsules targeted to home consumers was the winning business model, it began selling online, opening premium brick & mortar stores called *Nespresso Boutiques* at prime locations, and establishing a consumer community through the Nespresso Club²². For the past three decades Nespresso had achieved independent and autonomous management from Nestlé, being then present in over 60 countries, employing nearly 10,000 people and exceeding annual sales of 1 billion CHF^{23 24}, a value that added up to the more than 27 billion capsules sold worldwide since its foundation²⁵.

Besides its original premium positioning, Nespresso had turned its focus on both B2C and B2B channels, with clear efforts on delivering the highest quality coffee possible in the capsule form-factor through the use of continuous innovation. Each year the company launched several new *grand cru*²⁶ coffees as well as different designed coffee machines that introduced new features along the way. The most differentiating element however, was probably the Nespresso Club, a community of consumers leveraged by the firm's position in the online channel (an e-commerce platform first introduced in 1998²⁷) that offered them an array of personalized services and a close relationship with the brand. In fact, the choice of Hollywood actor George Clooney as the brand ambassador back in

²¹ Source: Nestlé Portugal corporate brochure (2013).

²² Source: Ecommerce-Digest online.

²³ Approximately €930 million.

²⁴ Source: Nestle-Nespresso online.

²⁵ Source: New York Times online (2012).

²⁶ Grand Cru refers to the flavor of the Nespresso coffee capsule.

²⁷ Source: Nespresso History Factsheet.

2006 was made by club members²⁸, as part of the brand's first world acclaimed communication campaign.

Nespresso was clearly ahead of its time when it forged the coffee capsule system (from now on referred as CCS) idea and brought it to life, and as with all pioneers, there comes a time when patents expire and the road for competitors to thrive becomes clear. The industry became extremely dynamic as other players entered the market and made it gradually less concentrated. Other manufacturers came up with their own proprietary CCS and even retailer brands launched their own.

For the Portuguese market, Nespresso made its debut in 2003 and managed to be the sole player for 4 years. As usual, sales were channeled largely through the online store, as well as marginally through the growing network of boutique store locations. As of 2011, Nespresso was the leader in capsule sales, but not in machines, even though 13% of Portuguese homes owned a Nespresso coffee machine and 37% of the cumulative number of machines were Nespresso branded²⁹. The position occupied for capsules in terms of volume was 47% of the total market, approximately 260 million units sold (leadership acquired in sales value as well)³⁰. Nonetheless, here the growth tendency was negative, as sales were quickly being transferred to other players every year (**See exhibit 1**).

The introduction of such a concept in a country like Portugal had serious implications for the coffee industry, and Nespresso was able to influence a culture of out-of-home consumption to an in-home one. While this was true, the Nespresso CCS was not cheap by any means, mainly due to the initial investment that had to be made in a coffee machine. The price for these started at above €100 for the most basic type of machine, although the average price for a single capsule was remarkably competitive at just €0.33 per unit, as they were sold in packs of 10 capsules each (**See exhibit 2**), and so consumers would easily reach break-even point after investing in a machine.

²⁸ Source: Nespresso History Factsheet.

²⁹ Source: GFK (2011).

³⁰ Source: Nestlé internal data (2011).

Nescafé

Nescafé had been one of the most famous coffee brands in the world and it was the most important brand for the Nestlé Group in terms of sales, with approximately 11 billion CHF³¹ in 2011³². The concept behind it originated in Brazil in the 1930s, when the government challenged Nestlé to create a quality soluble coffee that would keep the coffee's original flavor. After nearly seven years of research and development, Nescafé was launched in Switzerland, having expanded to other countries shortly afterwards. It grew to become the world reference in soluble coffee. In Portugal, the power of the Nescafé brand was fairly modest, as the market for soluble coffees was extremely small, at less than 10% of the total coffee market³³.

Nescafé Dolce Gusto

In 2006, Nestlé decided it wanted Nescafé to give continuity to the path built by Nespresso for more than two decades. It firmly believed that the future of coffee was in single-serve capsules and that Nescafé had to follow the trend. NDG was born. An espresso machine, resulting of a partnership with Krups³⁴, a coffee capsule system that was capable of handling not only hot, but cold beverages as well, with a proprietary and innovative technology and irreverent design. It was described as being a multi-beverage system. France and Germany were the first markets to launch the newly created brand.

Portugal was part of the first wave of countries to be able to launch NDG and so in the following year it met that goal. The brand sought to completely reinvent the way of having beverages at home, through the elements of pleasure, quality, variety, availability, convenience and design. It achieved this by seeking a broader target consumer, younger, attracted by the new tendencies, aiming to be a product that could reach any home with medium purchasing power. Evidently, NDG came with an unusual variety of beverages for a capsule system. They were hot and cold ones, so that the whole family could enjoy and was now sold in modern distribution (in addition to having an

³¹ Approximately €10 billion.

³² Source: Nestlé annual report (2012).

³³ Source: Diário de Notícias online according to Nielsen (2006).

³⁴ A world renowned coffee machine manufacturer owned by Groupe SEB, the world leader in small household electric appliances.

online store), as opposed to Nespresso's e-commerce and boutique strategy. NDG would democratize the coffee capsule market in Portugal, since the only player at the time followed a more premium approach. The acceptance was exceptionally positive and the country would become a top 5 market for Nestlé in NDG.

The new concept in coffee capsule systems was of high build quality and particularly ease of use. The possibility to choose a hot or cold beverage was its main selling point, as well as the proprietary capsule. Melody, NDG's first coffee machine was available in three different colors at the time of launch, with two different price-points, one being higher due to a special metal finish (**See exhibit 3**). Consequently, there were five different capsules available in the first year: Espresso Intenso, Decaffeinato, Chococino, Cappuccino and Latte Macchiato (**See exhibit 4**). The beverages that were made of two distinct ingredients were named white cups, due to the fact that for instance, a single Chococino beverage had to be made with a black capsule containing a chocolate powder blend and an extra white one containing milk. The pricing was aligned with the market: €0.27 for a single NDG Espresso as opposed to the average €0.55 in a typical Portuguese coffee shop and €0.30 for a Nespresso. A NDG Cappuccino however, would be significantly cheaper than one purchased out-of-home, €0.53 versus €1.5 on average. A standard pack of NDG capsules contained 16 units, when most of the competition offered only 10.

Indeed, the distribution strategy of NDG was critical for its success. Since it was a two-sided business (machine and capsule) there had to be an integrated strategy between Nestlé and Krups that would assure the presence of a NDG machine inside the homes of Portuguese consumers. The machines were not a direct source of revenue however, the capsules were, and therefore synergies had to be thoroughly created. Krups retained all the margins regarding their machines, as they were responsible not only for manufacturing them, but also working in a sell-in³⁵ perspective. On the other hand, Nestlé collected margins in capsules and was responsible for supporting Krups with selling their machines in a sell-out³⁶ standpoint, meaning all the marketing communications strategy was outlined by the NDG team. It was decided a generalized distribution strategy for the brand, with only machines being sold at home appliance stores, both machines and

³⁵ Sell-in is the act of selling a good to a customer, namely a retailer, in the manufacturer's perspective.

³⁶ Sell-out is the act of selling a good to a consumer, in the retailer's perspective.

capsules being sold at hypermarkets and large supermarkets, and only capsules being sold at small supermarkets. The placement for capsules in the shelf was near the roast and ground coffee section.

The Coffee Industry

In the World

One of the most consumed beverages in the world, Coffee was also considered the 2nd most valuable commodity since the 1970's, falling behind crude oil³⁷. Almost 8.5 million tons of coffee were produced in 2011³⁸, where over 90% of the volume came from developing countries, with Brazil as the undisputable top producer, followed by Vietnam and Indonesia (**See exhibit 5**). As for coffee consumption, Finland was at the top of the list, with an average of 12 kg per capita in 2008, followed by Norway and Iceland. Portugal came in 24th place, just above the United States, at an average of 4.3 kg per capita (**See exhibit 6**). The average annual consumption growth rate for the past 10 years was 2.5% however, the rate for the traditional markets of North America, Western Europe and Japan was considerable lower at 1.1%³⁹. At this rate, the industry could reach 9.5 billion tons by 2020. Yet, the International Coffee Organization alerted that the global financial and economic crisis, combined with the rising of production costs, could lead to a reduction in coffee supply, which consequently could slow down coffee consumption. The top 3 companies leading this growth in terms of sales value (excluding retailer brands) were Nestlé, Kraft Foods and Sara Lee as of 2011 (**See exhibit 7**). In value the entire industry grew 11% versus the previous year.

In Portugal

The Portuguese were well known for their coffee consumption habits, especially the out-of-home espresso, or *bica*⁴⁰, even though they were not even a top 20 country in

³⁷ Source: UN Conference on Trade and Development Commodity Yearbook.

³⁸ Source: UN Food & Agriculture Organization (2011).

³⁹ Source: Academia do Café online according to International Coffee Organization (2011).

⁴⁰ Bica is a Portuguese expression for espresso coffee.

terms of consumption per capita (**See exhibit 6**). In 2011, about 76% of the population followed this habit, with a slight growth tendency in domestic consumption since 2009, going from 20% to 24% for in-home consumption⁴¹. Essentially, the economic crisis was believed to be the reason behind this shift. The daily average was 2.2 cups per capita and logically the most preferred type of coffee was the espresso, as well as capsules or pods⁴² that allowed for a simpler and cleaner way of making coffee. Total consumption reached 25.2 million cups of coffee (covering only 85% of the market), which translated in nearly 370 million euros. As of that year there were roughly 40 relevant coffee brands in Portugal owned by 16 companies that make up 85% of the market⁴³. Delta Cafés, Nestlé and retailer brands as a whole were the top 3 players in terms of sales value in descending order (**See exhibit 8**). The entire Portuguese market grew 18% in value from 2010 to 2011.

The Single-serve Coffee Industry

In the world

Granted being a small industry, representing sales of up to 5 billion euros in 2011 (just 8% of the total coffee industry), the single-serve coffee business (capsules and pods) was continuously showing signs of being a fast-growing category, since this value indicated a 31.3% increase versus the previous year⁴⁴. France was a firm leader as the most valuable single-serve coffee market, followed by Germany and USA. Portugal came in at 10th place (**See exhibit 9**). As for the main players, Nestlé held the top spot with 35% share, followed by Sara Lee (18%) and Kraft Foods (8%) (**See exhibit 10**). Most importantly, a third of the total industry consisted of numerous other smaller players, from which retailer brands were to be noted⁴⁵.

⁴¹ Source: Academia do Café online (2012).

⁴² Coffee capsules are single-serve portions inside an aluminum or plastic capsule shaped container, whereas coffee pods are small paper pouches that hold a single-serve portion as well.

⁴³ Source: Academia do Café online (2012).

⁴⁴ Source: Reuters online (2012).

⁴⁵ Source: Reuters online (2012).

In Portugal

The single-serve coffee industry in Portugal had proven to be one of the most dynamic and valuable in the world. Indeed, once Nespresso had placed the building blocks for the whole industry, other players were inevitably going to emerge. Just one month after NDG rolled out to the Portuguese market, the country's leading coffee company Delta Cafés, created its own CCS brand, Delta Q, a multi-beverage system like NDG's (**See exhibit 2**). As national coffee experts, Delta Q's positioning was considered as mainstream, though it was significantly close to Nespresso's premium setting. It even adopted a mixed distribution strategy, having its own boutiques, an online store and being available for purchase at modern distribution. Three years later, retailer Pingo Doce⁴⁶ turned Portugal into the first market to have a retailer brand CCS (**See exhibit 2**), a highly disruptive move that would democratize the whole industry even more. Its positioning was like any other retailer brand, price oriented, and evidently it could be sold only at Pingo Doce's stores. By the end of 2011, the market was occupied by five main players Nespresso, NDG, Delta Q, Pingo Doce and Tassimo⁴⁷ (**See exhibit 11**).

When considering only capsules, the market was growing over 44% equally in volume and value sales⁴⁸. Nespresso was leading with 47% market share in volume (although with 1,500 basis points less than the previous year), followed by NDG with 23% market share, Delta Q with 17%, and retailer brands with 10%, which were generally represented by Pingo Doce (**See exhibit 1**). As for machines, home penetration was 35%, with Nespresso appearing in first place, followed by NDG⁴⁹ and Delta Q⁵⁰. Strikingly, this level of penetration for Portugal was the highest when compared to the rest of the world. Additionally, price was the main driver for this market. In one year, the average price dropped from €144 to €87⁵¹ per machine. Pingo Doce was the primary responsible for this decrease, offering its own branded machine at a price-point of only €49, a measure that would make it the leader in sales volume immediately after launching. The market

⁴⁶ Pingo Doce was widely famous for its quality own brand.

⁴⁷ Tassimo was one of Kraft Foods' coffee brands.

⁴⁸ Source: GFK (2011).

⁴⁹ Portugal had the highest home penetration percentage in the world for NDG machines.

⁵⁰ Source: GFK (2011).

⁵¹ Source: Nestlé internal data (2011).

experienced considerable growth in volume, but nearly zero in sales value, clearly due to the observed price cuts.

First steps, from 2007 to 2010

António recognized that NDG was probably Nestlé's most important innovation since Nespresso, as a source of revenue point of view. This meant that strategic markets for the brand had a relevant amount of marketing budget to handle and with it achieve ambitious goals. Portugal was fortunate to be selected immediately after the first year of introduction in France and Germany. NDG's initial marketing strategy was described as an integrated communications approach in a path-to-purchase perspective. Typically, four main building blocks, each consisting of different *above* and *below the line* activities, that when combined influenced consumers to be near a purchase decision (**See exhibit 12**).

First off, it was necessary to generate brand awareness inside the homes of potential NDG consumers and inform them about the characteristics of the product (**See exhibit 13**). To do so, the team relied on mass media by means of TV spots each year that focused on NDG's ability to be a multi-beverage system, as well as the unique design features and shapes of its machines. Some noteworthy taglines used on these ads were “*A coffee shop inside your home*” and “*Be surprised by a new world of beverages*”. In addition, radio was also a part of NDG's campaigns throughout the first years, through the use of sponsored sweepstakes on Portugal's most listened morning shows. The online store was also a very useful tool for spreading the brand's message. As soon as there were sufficient users online, NDG began taking advantage of the collected consumer information and developed select CRM⁵² campaigns when launching new capsules or machines, which were primarily price reductions. Consequently, such launching events were leveraged offline by inviting Portuguese celebrities to attend them, as a clear PR⁵³ move.

However, potential NDG consumers did not spend all their time at home, therefore it was necessary to impact and engage them out-of-home (**See exhibit 13**). To achieve

⁵² Customer Relationship Management.

⁵³ Public relations.

this goal the brand relied mainly on outdoor advertising, placed at Portugal's most busy streets and avenues. At shopping malls, people witnessed island stands with large scale NDG coffee machines on top being showcased as a way to surely catch their attention. Other occasions, such as national congresses and university events were also opportunities for NDG to be present as a coffee-break provider.

Having assured the last two premises, NDG coupled the above described marketing communication activities with specific actions to guide the consumer inside the store (**See exhibit 13**). "*POS⁵⁴ brand activation was a critical success factor for NDG's beginning in the Portuguese market, and continues to be*", António pointed out. Store entrance alarm strips were used several times to display ads, POS materials were combined to form a NDG *shop-in-shop⁵⁵*, *ambassador stands⁵⁶* were created to showcase the entire product portfolio and even extra display stands were placed at unusual stores, like home decoration ones.

Finally, NDG relied on complementary POS activities to trigger the purchase at store shelves (**See exhibit 13**). Again, numerous in-store brand activations were made possible with corridor islands, ends of gondola and display stands. Ultimately, tasting events were exceptionally important to complement the entire path-to-purchase and convince shoppers to become NDG consumers.

By the end of the considered period, NDG was not only an exceptional performer in the Portuguese market, but was also presented with several distribution, consumer and design awards, which were the public's recognition for the António and his team's efforts.

Despite NDG's performance up until then, 2010 was an important year for the competition. Surprisingly, Portugal's coffee leader Delta Cafés had not leveraged its capsule brand Delta Q reasonably enough to become a serious threat. At the same time, Pingo Doce made one of the most important product launches of the industry, by becoming the first retailer in the world to have its own CCS brand, which in this case was a multi-beverage offering as well. Subsequently, Tassimo entered the market with yet another multi-beverage system. Therefore, even though these players had only started to

⁵⁴ Point-of-sales.

⁵⁵ The shop-in-shop concept refers to creating a special space in-store that resembles a small shop for a single brand.

⁵⁶ A unique NDG display stand made from premium materials showcasing the entire NDG product portfolio, from machines to capsules.

scratch the surface, it only meant that their growth margin was potentially higher than NDG's and ultimately their moves had to be closely watched in the years to come.

Buondi & Sical in capsules, fighting local with local

António's suspicions regarding what the competition could do in the short term proved to be correct. A perfect example was when NDG launched the first machine under €100, the Piccolo at €79 (**See exhibit 14**). Just two months later Pingo Doce announced their new model at €49. Such a move was the primary responsible for a sales volume boost in the coffee capsules machine market. *"The effort of buying a coffee capsule machine was no longer emotional, retailer brands started to depreciate this side of the purchase decision and so 2011 was the year we fought the most for the machine market, trying not to deteriorate it even more in terms of sales value"*, António confessed. At a certain point in time, coffee capsule machines below €70 per unit represented more than half of total sales in the market⁵⁷. On the other hand, NDG's greatest rival, Delta Q, while having to be preoccupied with the previous issues as well, was showing no signs of slowing down. It turned its focus to innovation by launching, for instance, a range of tea capsules in a partnership with Tetley and a "Power Coffee" capsule, aimed at consumers who needed the immediate caffeine boost, such as students and so on. At the same time, NDG's closer brother and competitor Nespresso continued to be the leader and was still a benchmark of the industry, granted it was not competing in the food retail channel. Moreover, various other players were gradually entering market taking their own spot (**See exhibit 1**). An industry that was extremely concentrated at its genesis, and for the many years that followed it, was growing towards the opposite effect.

While attempting to improve the machines situation, António and the NDG team knew something had to be done on the capsules side. Undeniably, innovation was held as the one of most important growth driver of such an industry although, on paper, sales promotions were the answer to many momentary problems. The strategy had to be long-term. At this stage, only one of two things could be done: either continue on leveraging the success of the espresso range of capsules, or do something completely different,

⁵⁷ Source: Nestlé internal data by GFK (2011).

something that was not even allowed by Nestlé headquarters in Switzerland. Clearly a radical decision had to be made and so, after several months of struggling with Nestlé standards and guidelines, the Portuguese NDG team managed to get permission to start selling other brands inside NDG capsules, becoming yet again, the first market to accomplish such an achievement.

These were not just any brands however, they were Buondi and Sical (**See exhibit 15**), two Portuguese coffee brands owned by Nestlé, which had a combined history of nearly 90 years in the country. Buondi and Sical were favorites amongst the out-of-home coffee drinkers, as the first one was not available for purchase at modern distribution at the time. NDG was undoubtedly taking the coffee consumption transfer from out-of-home to in-home to a whole new level. Moreover, the rationale behind these two product launches was to challenge local competitors with Nestlé's own local brands in an attempt to connect even further with coffee consumers and take advantage of the already created bond between them and the two brands. In the development stage of both blends, various efforts were made in order to make them as close as possible to what consumers were used to drink when going out for a cup of coffee at their favorite place. Naturally, Buondi and Sical NDG capsules were a hit, regardless of the sales cannibalization effect observed on the other espressos⁵⁸, a calculated risk in António's opinion. Both SKU's⁵⁹ jumped instantly to the top five of NDG sales (**See exhibit 16**). Some consumers even admitted that if NDG did not offer Buondi or Sical that would have chosen a competitor's capsule system⁶⁰. Results again proved the hard work was not in vain.

Present day – was sales promotion the answer?

Going back to that rainy April morning, António reflected upon the progressively shifting market landscape and how it posed exhausting, but exciting new challenges for the present year. 2012 was witnessed as the year that coffee capsule machines were regularly available for a bare €49 due to Delta Q and Pingo Doce's recent moves. The competition's promotion investment was not slowing down and António asked himself if

⁵⁸ Source: Nestlé internal data (2011).

⁵⁹ SKU refers to Stock Keeping Unit, a unique product reference for sale.

⁶⁰ Nestlé internal data (2012).

NDG was going down the same path. Furthermore, the home appliance's market was decreasing and showing no signs of future recovery⁶¹. Most importantly, the VAT increase from 13% to 23% imposed by the government in 2011 enlarged NDG's standard capsules pack price from €4.79 to €5.21 (**See exhibit 15**). This external condition put NDG in a delicate position of becoming the only player in the market selling standard capsule packs at a price-point above €5 (**See exhibit 2**).

Tough challenges could only be surpassed by setting ambitious goals. The sales target for that year was 105,000 machines, 150 million capsules for retail and 2 million capsules for the online store. Unsurprisingly, a way to achieve this mark was by resorting to sales promotions. Several sell-out oriented promotional activities were planned for that year. A sweepstake involving offering one year house rent to the winning participant, a bonus pack which contained select capsule varieties aiming to provide a tasting experience to consumers, POS implementations following the same logic as in previous years (ambassador stands, display stands, shop-in-shop, tasting events, and others), internet based activities on the online store, and many other types of promotional mechanics. In the end, the plan included many elements proven to be effective in the past, but the investment necessary was ruining NDG's profitability.

The time of the team meeting had come and on his way to room 305 António discussed with a colleague how NDG as a promotion driven brand was not his vision at all. Market share was being transferred to Delta Q and retailer brands and there was an urgent need to recover it. The gap between NDG and its competitors had to be increased again, but in the good way. To António's astonishment, the answer could actually be hidden behind a sales promotion tactic. A very good way to decrease the constant investment of promotions was to create a brand new and differently sized capsules pack, one that would become a standard SKU. This meant that the only significant cost associated with the retailer would be related to a listing fee. António faced his team with three critical questions regarding the new pack:

- How many SKU's would be used for the new format?
- Which ones would be chosen for it?
- How many capsules would the new pack contain?

⁶¹ Source: Nestlé internal data (2012).

The first and second questions had a straightforward solution. Espresso Intenso was NDG's top selling capsule variety (**See exhibit 16**), therefore it had to be considered. Still, Buondi and Sical were an undeniable success and continued growing at a fast pace. In addition, the latter were exclusive capsules for the Portuguese market which translated into more flexible production decisions. A consensus was found and it was decided three SKU's would be included: Espresso Intenso, Buondi and Sical. The real issue was in the third question.

Surely, the new pack had to be either larger or smaller than the standard one. Due to manufacturing issues, the minimum amount of capsules that could be put inside a NDG capsules pack was 12, hence the first option was found. As for the maximum, there were no constraints, but there had to be a reasoning underneath such decision. "*A large pack containing 30 capsules would be ideal for a month worth of coffee consumption*", someone in the room said. António agreed, he looked at his colleagues and asked: "*Should we sell in packs of 12 or 30 capsules?*" (**See exhibit 17**). The brainstorm over the real dilemma had begun.

As the discussion extended itself throughout the afternoon, another important issue arose: pricing. For the 12 capsules pack, the price per capsule could not be higher than NDG's standard pack and surely it had to be priced closer the competition's usual 10 capsules pack. As a result, António approved €3.90 for the hypothetical 12 capsules pack. As for the larger one, there were indications from the finance department that in order to make it profitable the price reduction per capsule could not be higher than 4 cents. The corresponding price would then be €8.89 for a NDG pack containing 30 capsules (**See exhibit 17**). The next thing to do was a real life test to both formats. In order to help with this matter, the sales team, who were present at the meeting, were asked to negotiate with a hypermarkets retailer and list both SKUs in a few stores for a short period of time. The goal was to do marketing research at the point-of-sales where it was possible to observe shopper reaction to the new packs and through one-on-one in-depth interviews obtain additional and potentially essential insights.

The day had been a long one and António Sousa could not help but feel tired and somewhat discouraged about how tough and hostile the industry had become. In fact, he was afraid his brand could not survive, in the long run, the aggressive promotions being

imposed by the market. Nevertheless, he had confidence that he and his team had found a sustainable answer that could be the break NDG needed.

Conclusion

Nearly two months after that unpleasant Friday of April the outcome of the new packs' field study was finally disclosed. For the 12 capsules pack, nearly all questioned shoppers failed to visually notice the difference when compared to a standard NDG pack, some even complained saying they were tricked by the new size by not being able to tell the difference. Subsequently, in a few cases the lower price was indeed detected, but perceived as a temporary price reduction. One shopper declared "*If the price is the same as the 16 capsules I do not see the advantage*", while another had a more positive opinion saying "*It is a good pack for the end of the month when I do not have so much money to spend*". As for the 30 capsules one, price per capsule being more important versus per pack was the key learning originated from most interviewed shoppers. "*This fits completely my needs in terms of number of capsules and price*", one woman responded. António had in his hands what he believed were polarizing results, yet he recognized a slight tendency of one over the other. Even so, his question remained the same: a smaller or a larger capsules pack? What was the right solution?

Exhibits

Exhibit 1 Portugal Top Coffee Capsules Brands

Brand	Volume*		Value**	
	2010	2011	2010	2011
Nespresso	0.62	0.47	0.65	0.51
Nescafé Dolce Gusto	0.21	0.23	0.21	0.24
Delta Q	0.13	0.17	0.12	0.16
Retailer Brands	0.01	0.10	0.01	0.07
Tassimo	0.01	0.01	0.01	0.01
Others	0.03	0.02	0.01	0.01
TOTAL***	398	575	126	175
Growth	+ 45%		+ 44%	

* Market share % in number of capsules.

** Market share % in sales value €.

*** Total in absolute value millions €.

Source: Nestlé internal data (2011).

Exhibit 2 Competitors Capsules and Machines Portfolio

Nespresso (10 capsules per pack)



ESSENZA



€99,99

INISSA



€99,99

U



€139,99

€149,99

PIXIE



€169,99

€149,99

CITIZ/CITIZ&MILK



€179,99

€249,99

MAESTRIA



€449,99

€599,99

Delta Q (10 capsules per pack)



Coffee
Mainstream

€3.29



Coffee Premium

€3.70



Coffee Premium
Origins

€3.70



Tisanas

€2.99



Tea

€3.70

QOSMO GLOSS



€29

€49

QOOL MANUAL



€59

QOOL AUTOMATIC



€79

ALQIMIA



€149

BUGATTI



€499



Pingo Doce (16 capsules per pack)



Espresso

€3.52



Decaffeinate

€3.52



Premium

€3.52

CAFFITALY



€49

Exhibit 3 NDG Machines 2007 Portfolio



Source: Nestlé internal data (2007).

Exhibit 4 NDG Capsules 2007 Portfolio



* White cups beverages are prepared using 2 capsules; therefore a pack contains a total of 8 beverages.
Source: Nestlé Internal Data (2007).

Exhibit 5 World Top Coffee Producers

Country	2011*
Brazil	2.70
Vietnam	1.28
Indonesia	0.63
Colombia	0.47
Ethiopia	0.37
Peru	0.33
India	0.30
Honduras	0.28
Mexico	0.25
Guatemala	0.24
World Total	8.46

* Millions of metric tons.

Source: UN Food & Agriculture Organization (2011).

Exhibit 6 World Coffee Consumption per capita

Country	2008*
Finland	12.0
Norway	9.9
Iceland	9.0
Denmark	8.7
Netherlands	8.4
Sweden	8.2
Switzerland	7.9
Belgium	6.8
Canada	6.5
Bosnia and Herzegovina	6.2
Austria	6.1
Italy	5.9
Lithuania	5.8
Brazil	5.8
Germany	5.5
Greece	5.5
France	5.4
Croatia	5.1
Cyprus	4.9
Lebanon	4.8
Serbia	4.5
Spain	4.5

Estonia	4.5
Portugal	4.3
United States	4.2
Macedonia	4.2
Slovenia	4.1
Slovakia	4.0
Czech Republic	4.0
Brunei	4.0
Honduras	3.9
Costa Rica	3.8
Israel	3.8
New Zealand	3.7
Algeria	3.5
Ireland	3.5
Latvia	3.4
Gibraltar	3.4
Japan	3.3
Bermuda	3.3
Hungary	3.1
Australia	3.0
Bulgaria	2.9
United Kingdom	2.8
Poland	2.4
Romania	2.3
Malta	2.3
Dominican Republic	2.3
Qatar	2.2
Haiti	2.1

* Kilograms per person per year.
Source: World Resources Institute (2008).

Exhibit 7 World Top Coffee Companies

Company	Value*	
	2010	2011
Nestlé	10.4	11.5
Kraft Foods	5.5	5.9
Retailer Brands	3.4	3.8
Sara Lee	2.3	2.6
JM Smucker	1.3	1.5
Others	25.8	28.6
TOTAL	48.7	53.9
Growth	+ 11%	

* Sales value billion €.
Source: Euromonitor International (2011).

Exhibit 8 Portugal Top Coffee Companies

Company	Value*	
	2010	2011
Delta	39.4	53.7
Nestlé	49.7	45.9
Retailer Brands	29.1	38.9
Massimo Zanetti	5.4	5.1
Nutricafés	6.5	5
Others	87.1	107
TOTAL	217.2	255.6
Growth	+ 18%	

* Sales value million €.

Source: Euromonitor International (2011).

Exhibit 9 Coffee Capsules Top 10 Countries

Country	2011*
France	1.60
Germany	0.98
USA	0.73
Netherlands	0.47
Italy	0.31
Spain	0.30
Switzerland	0.25
Belgium	0.22
Austria	0.16
Portugal	0.16

* Sales in billion dollars.

Source: Euromonitor International (2011).

Exhibit 10 World Top Coffee Capsules Companies

Company	2011*
Nestlé	34.7
Sara Lee	17.7
Kraft Foods	8.1
Green Mountain	7.6
Lavazza	1.3
Others	30.6

* Market share % in sales value.

Source: Euromonitor International (2011).

Exhibit 11 Portugal Top Coffee Capsule Machines Brands

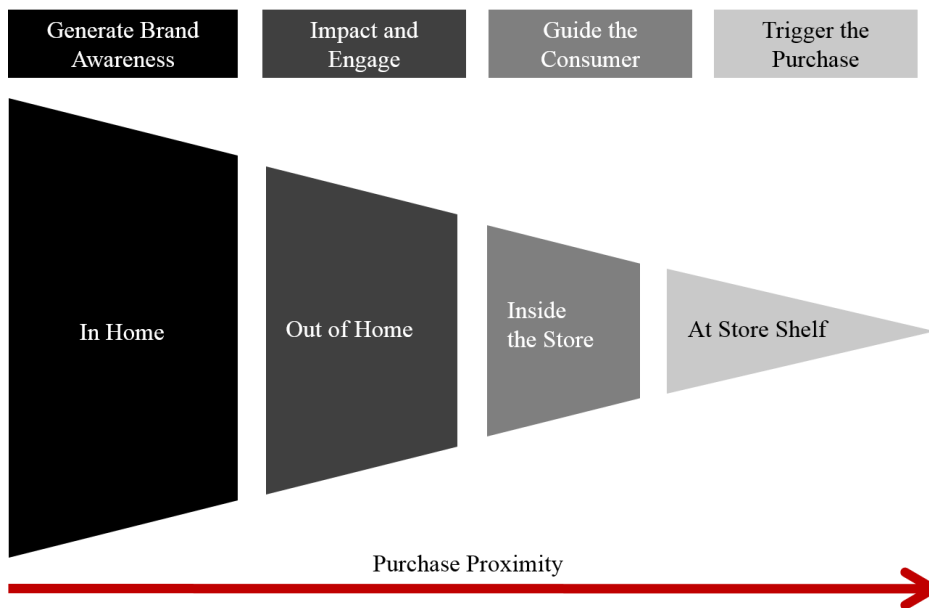
Brand	Volume* 2011
Nespresso	37
Nescafé Dolce Gusto	29
Delta Q	18
Pingo Doce	13
Tassimo	2
Others	3
TOTAL**	1.32

* Market share % in coffee capsule machine sales.

** Cumulative number of coffee capsule machines in millions.

Source: Nestlé internal data (2011).

Exhibit 12 NDG Path to Purchase Perspective



Source: Nestlé internal data (2010).

Exhibit 13 NDG Marketing and Trade Activities 2007-2010

Television



CRM and Internet

PELO SEU ANIVERSÁRIO E PELA PRENDA QUE TEMOS PARA SI.

Muitos parabéns Maria! Num dia tão especial como este damos-lhe uma oportunidade única!

Encomende uma máquina NESCAFÉ® Dolce Gusto® Melody durante os próximos 7 dias e beneficie de um preço exclusivo de 99€*. (Preço médio de venda: 129,90€.)

Para receber a sua NESCAFÉ® Dolce Gusto® no conforto de sua casa, encomende-a já aqui.

Depois já pode convidar os seus amigos a experimentar todas as bebidas que vai poder preparar na coffeshop de sua casa.

Feliz Aniversário com a Nestlé

* Está oferta é pessoal e intransmissível, válida exclusivamente para uma encomenda e uma máquina por consumidor. Antes de efectuar a sua encomenda leia as Condições da Promoção.

Saiba mais sobre NESCAFÉ® Dolce Gusto® em www.dolce-gusto.pt
Linha NESCAFÉ® Dolce Gusto® - 800 200 153 (das 8h30 às 18h30 nos dias úteis)

PREÇO ESPECIAL 99€

OFEREÇA-LHE A NOVA KRUPS NESCAFÉ® DOLCE GUSTO® CIRCOLO.

No próximo Dia da Mãe esconda as flores e os presentes do costume. Se quer realmente surpreender a sua mãe ofereça-lhe a nova KRUPS NESCAFÉ® Dolce Gusto® Circolo.

Uma oportunidade exclusiva de ela ter uma coffeshop* em casa por um preço muito especial para si. Para encomendar, basta clicar aqui e a sua mãe receberá a máquina directamente na morada que indicar. Conheça as condições de venda desta promoção.

Oferta especial Dia da Mãe - 149,90€! Apenas 119€ (preço médio)

Para mais informações contacte o Serviço ao Consumidor NESCAFÉ® Dolce Gusto® nlc@nestle.com
Linha NESCAFÉ® Dolce Gusto®
800 200 153 - Das 8h30 às 18h30

Public Relations



Outdoors



Retailers Store Entrance



Presence in Events



Shop in Shop



Ambassador Stand



Extra Display Stand



Retailer Corridor Island



Tasting Events



Exhibit 14 NDG Current Machines Portfolio



Source: Nestlé internal data (2012).

Exhibit 15 NDG Current Capsules Portfolio

Black Cups



Espresso
Intenso



Espresso
Ristretto



Espresso
Decaffeinato



Sical



Buondi



Nesquik



Nestea Peach



Espresso*



Café Lungo*



Café au
Lait*



Aroma*



Café Lungo
Decaffeinato*



Espresso
Macchiato
Cortado*

White Cups



Latte
Macchiato



Cappuccino



Cappuccino
Light



Cappuccino Ice



Chococino



Latte
Macchiato
Vanilla*



Mocha*

* Only available online.

All packs contain 16 capsules and are priced at €5.21.

Source: Nestlé internal data (2012).

Exhibit 16 NDG Capsules Sales Rankings

SKU*	2011**
Espresso Intenso	35.4
Espresso Ristretto	17.5
Buondi	14.6
Sical	10.7
Espresso Decaffeinato	7.5
Cappuccino	3.2
Nesquik	3.2
Chococino	2.9
Latte Macchiato	2.8
Cappuccino Light	0.9
Nestea Peach	0.7
Cappuccino Ice	0.6

* Excluding SKU's sold exclusively online.

** Volume sales (KG) in % of total NDG sales.

Source: Nielsen Market Track (2011).

Exhibit 17 NDG 12 and 30 Capsules Packs

	Sical	Espresso Intenso	Buondi
12 Capsules €3.90/pack €0,325/capsule			
30 Capsules €8,89/pack €0,296/capsule			

Source: Nestlé Internal Data (2012).

Literature Review

Sales promotions effectiveness and preferences

Chandon et al. (2000) conducted a series of studies to American and French respondents with the goal of discovering if monetary savings are alone in explaining consumer response to sales promotions, in addition to understanding whether different benefits of a promotion impact how effective it is. In one of the studies, several monetary and nonmonetary promotions were evaluated on how they were influenced by promotion benefits, according to hedonic and utilitarian dimensions (See TN exhibit 1). Results showed that monetary promotions were predominantly associated with utilitarian benefits, whereas nonmonetary ones were more heterogeneously evaluated. In another study (See TN exhibit 2), purchase intentions were examined between utilitarian and hedonic products, divided by categories of high-equity and low-equity brands, and the effects of doing a promotion versus not doing one were analyzed. The outcome revealed, most notably, an exponential market share increase in utilitarian products belonging to high-equity brands after a monetary promotion was activated, whereas a nonmonetary promotion produced fairly modest results in the same product category. For hedonic high-equity hedonic products results were similar, yet proportionally inferior.

Further sales promotions literature encompasses a study conducted within the Porto region by researcher Ana Moura (1997), in order to determine Portuguese consumers' sensitivity towards promotions. The author concluded that consumers were, in general, hardly motivated to retrieve information about the benefits and attributes of different options available in the market. Purchases were influenced by ongoing promotions, especially for consumers who were not loyal to the brand they were considering. This influence was as great as the involvement and risk associated with the transaction. Consumers valued promotion advantages that were certain and immediate, while not preferring overdue rewards as much. Moreover, price reductions and extra product offers were the most appreciated mechanics. On the other hand, the least welcomed promotions were collecting proofs-of-purchase, which give consumers the right to redeem an offering later in the process.

Teaching Note

Increasing the gap: How Nescafé Dolce Gusto strived in a hostile competitive environment case was written by João Lamarão under the supervision of Professor Paulo Gonçalves Marcos. Its preparation was based on real events, albeit using a fictional character as the main actor; however data was properly altered in order to preserve company confidentiality. Consequently, it is meant to be used solely within the boundaries of a class room and not as primary data for third party readers.

The following suggested readings should help lecturers and students to better understand the underlying concepts within this case:

1. Kotler, P., Armstrong, G., Wong, V., Saunders, J., 2008. Principles of Marketing. Fifth European Edition: Pearson Education.
2. Chandon, P., Wansink, B., Laurent, G., 2000. A Benefit Congruency Framework of Sales Promotion Effectiveness. Vol. 64, pp 65-81. Journal of Marketing.
3. Moura, A., 1997. Promotions des Produits de Marque et Comportement d'Achat du Consommateur en Grande Surface: Cas de la Grande Distribution dans la Région de Porto – Portugal, pp 166-177, Ph.D. Dissertation, Institut Polytechnique de Lorraine, France.

Synopsis

Nescafé Dolce Gusto (from now on referred as NDG), a coffee capsule system brand owned by the Nestlé Group, the largest fast-moving consumer goods company in the world, first appeared in Portugal in 2007. At the time, its older brother Nespresso was the sole player in the market and the availability of coffee capsules was still restricted to the online channel and Nespresso's own boutique stores. Having identified this gap, Nestlé decided to give continuity to the coffee capsules trend and launched NDG in modern distribution, becoming the first coffee capsule system brand obtainable at supermarkets and hypermarkets. In addition, the brand's most differentiating attribute was being able to provide not only varieties of coffee, but also other types of beverages,

either hot or cold ones. Just a few months later, Delta, Portugal's leading coffee brand, launched its own system: Delta Q.

The Portuguese single-serve coffee industry was one of the most dynamic and challenging worldwide. Proof of that was the fact that it was the first country to have a retailer brand launch its own coffee capsule system back in 2010. In 2011 the sales growth for capsules was 44% both in volume and value. However, this type of business greatly relied on the capacity to place coffee capsule machines inside the homes of consumers. Portugal had the highest penetration rate when compared to the rest of the world at 35%, the leader being Nespresso, followed immediately by NDG and Delta Q.

The environment had become increasingly competitive and NDG was slowly starting to fall behind. Sales promotions were one of the most important industry growth drivers and the investment required to proceed on doing them was substantial. The brand had clear strategic directives aiming at avoiding sales promotions whenever possible, yet its competitors were not showing any signs of slowing down. A key milestone was the launch of Buondi and Sical, two national roast and ground coffee brands owned by Nestlé which enjoyed high levels of notoriety and for the first time were being converted into coffee capsules. This event considerably leveraged NDG's sales. Still, additional efforts had to be made in order to recover market share. 2012 was believed to be the year when NDG would finally increase the gap versus its competitors again. In that year, the Portuguese government imposed a VAT increase from 13% to 23%. An external circumstance initially identified as a reason for a sudden downfall, could be transformed into an opportunity for the brand to do something different. This tax increase rendered NDG as the only player selling a capsules pack above the €5 mark and it was crucial to understand if this posed as a barrier to consumption. Ironically, a sales promotions related solution was suggested: to launch a differently sized promotional capsules pack. The question now was whether this new format was going to be a 12 capsules or 30 capsules one, compared to the regular 16 capsules pack.

Suggested Assignment Questions

The following questions should be considered as an analysis and discussion guideline for students:

1. Analyze NDG's position in the Portuguese market by examining all the internal and external dimensions António needs to take into consideration when making decisions.
2. Describe NDG's main source of competitive advantage which was vital to achieve its position in the market today.
3. In the context of sales promotions, choose three different activities used by NDG, discuss their objectives, advantages and disadvantages, and provide future recommendations.
4. Identify the reasons behind NDG having decided to launch a differently sized capsules pack. Provide your initial advice to António on which format is the most suitable option.
5. For each pack, calculate how many capsules NDG would have to sell in order to achieve break-even point and based on your solution assess which is the better option from a financial point of view. Assume the following data to aid in your answer:

	12 caps pack	30 caps pack
Variable costs	1,08 €	2,70 €
PFME ⁶²	300 000 €	750 000 €
Other production costs	0,08 €	0,20 €
% of total capsules retail target	15%	
Retailer margin	20%	

Teaching Objectives

The following are the considered teaching objectives for this case:

1. To understand the behavior of the coffee industry both in Portugal and in the world, with significant emphasis on coffee capsule systems;

⁶² PFME: Product Fixed Marketing Expenditures.

2. To show how often times having a first-mover advantage does not guarantee a company's long-term success;
3. To highlight how the rivalry between manufacturers and retailer brands is shaping FMCG, especially in Portugal and the harsh environment companies are facing nowadays in a sales promotion-driven industry;
4. To illustrate the relevance and power of local brands in a coffee market such as the Portuguese one;
5. To generate a debate around sales promotions as one the most important growth drivers for brands nowadays, discussing the available techniques and their effectiveness;
6. To acquire insights on whether a packaging format decision could improve sales of a product;
7. To entice an analytical and numerical discussion aimed at taking accurate and tangible managerial decisions based on financial data.

Use of the Case

The key purpose of this case is to be utilized for class discussion on strategic marketing decisions companies require on making in order to become increasingly competitive. It aims to illustrate how several marketing tools can be strategically used in order to give a brand the upper-hand against its competitors, with a clear focus on sales promotions. For that reason, this case can be used in either undergraduate or graduate marketing related courses such as: strategic marketing, marketing communications or brand management. Nonetheless, due to its business strategy nature it can also be used in strategic management courses.

Relevant Theory

5 C's Analysis

Before formulating marketing strategies it is crucial to understand the internal and external business environment. Avery and Steenburgh (2010) pointed out the 5 C's

analysis (**See TN exhibit 3**) as a tool to identify such elements as it outlines five distinct dimensions of marketing environment with the ultimate goal of providing managers the appropriate foundations prior to making decisions. The 5 C's analysis comprises *customers, context, company, collaborators* and *competition*.

The first dimension involves understanding customers' needs, what motivates consumption and the decision making process behind it. Secondly, examining the context refers to the role of external factors (economic, socio-cultural, political/legal and technological) as platforms for business opportunities. As for the third dimension, *company*, managers should carefully determine what their business model is, figuring out what is the firm's core activity and how does it achieve financial results. Regarding *collaborators*, assessing the suitable partners who will help the company achieve its goals by creating business synergies is vital. The latter can commonly be suppliers, distributors or retailers. Lastly, measuring competitors' strategies and understanding how they pose as a threat is the last dimension of the 5 C's analysis.

Porter's Generic Competitive Strategies

Michael Porter (1985) grouped a set of competitive advantages into three generic strategies which companies can use in order to achieve the upper hand over the competition. A fourth strategy was later identified as a combination of the previous three and represents a situation where companies should not aim to be at (**See TN exhibit 4**).

The first strategy is *cost leadership* and it refers to a company's ability to produce goods and/or services in the most cost effective manner possible. Commonly it results from scale economies, learning effects, technological innovation, etc.

The second strategy is *differentiation* and it consists of selling a product with specific characteristics which are valued by customers. It can result from the product's attributes or performance, intangible elements and adaptation to consumption behaviors or to particular customer necessities. The benefit of such strategy comes from the company's ability to adequately value its offering in a way that the customer prefers it over the competition. Typically it is translated into a policy of high margins and low volumes or vice-versa.

The third strategy is *focus* and it involves concentrating all efforts in a particular market segment. Additionally, it can be combined with a *cost leadership* or *differentiation* competitive advantage. Adopting a *focus* strategy allows the company to define its own market boundaries where it can benefit from specific gains and as a consequence reduce pressure from competitors.

The fourth and final generic strategy is *middle of the road*. Some companies will attempt to be differentiated and highly cost effective while targeting a niche market segment, only to later realize they lack real commitment to any of the previous strategies and in the end do not obtain competitive advantages. Porter advises businesses to follow only one of the first three generic competitive strategies in the interest of becoming truly successful in the marketplace.

Sales Promotions

Kotler (2008) defined sales promotions as a set of techniques which have the ultimate purpose of increasing sales. While not being considered a sale by itself, sales promotions prepare the path to the transaction, creating an event that can strike its target audience and awake the will to buy. In this perspective, sales promotions can be separated into consumer promotions, such as price cuts, coupons, sweepstakes, etc., and trade promotions (or retailer promotions), which include special discounts, free goods, among others. Naturally, the objectives and the techniques used within the sales promotions scope differ depending on who is the target.

Analysis and Discussion

The proposed basis for analysis and discussion of this case is translated into six assignment questions, which are allocated according to the following structure of a 90 minute long class:

I. External and internal analysis

Question 1: Situation analysis 20 minutes

Question 2: Competitive advantage 10 minutes

II. Marketing assessment

<u>Question 3</u> : Sales promotions	15 minutes
<u>Question 4</u> : Dilemma recommendation	15 minutes
<u>Question 5</u> : Dilemma solution	20 minutes

Below is the recommended reasoning for each assignment question:

1. Analyze NDG's position in the Portuguese market by examining all the internal and external dimensions António needs to take into consideration when making decisions.

A useful framework used to perform a detailed examination of the market environment is the 5 C's analysis (**See TN exhibit 3**). It provides extensive information on internal and external variables by describing five distinct dimensions: customers, company, competition, collaborators and context.

Customers

For NDG, the customer dimension refers to shoppers and consumers. When looking at overall FMCG buying behavior, the Portuguese are revealed to be spending less per act of purchase, although purchasing more often, while increasingly preferring large retail areas (**Page 6**). They are also very mindful of prices, as their buying decisions are rational and demanding, being constantly on the lookout for promotions (**Page 7**). When considering the total coffee industry, it is fair to say that while not being an exceptionally large market, Portugal has still a respectable size and consumption per capita at 4.3 kg (**Page 13**), which is slightly below the world average of 4.8 kg per capita (**See exhibit 6**), taking into account the 50 country sample data. It is known that 76% of the population drinks coffee away from home, while the 24% remaining do it in-home and are growing in number from previous years (**Page 13**). This growth rate is extremely important for NDG given that its target consumer is the home coffee drinker. When observing solely the single-serve coffee industry however, where NDG operates, Portugal becomes the 10th most valuable country in the world (**See exhibit 9**). Growth levels are high at 45% in volume from 2010 to 2011, which translated in a total of nearly 400 million capsules sold last year. This data is undoubtedly a good indicator of the coffee capsules segment dimension.

Context

The 2nd dimension to be examined is context, which involves understanding the role of the following external factors:

Economic: The economic crisis lived in Portugal is by far one of the biggest threats to NDG's business. Being the 2nd worst performer in Europe, most of its population admit feeling a direct impact from the crisis. The effects of inflation and substandard wages bear consequences on overall purchasing power, which is the lowest in 27 years (**Page 6**). As a result, the industry is driven by sales promotions where retailers and manufacturers are forced to engage in price reductions and other types of mechanics in order to drive consumption levels up, at the cost of margins and profitability (**Page 7**).

Socio-Cultural: The Portuguese are typically coffee drinkers. Approximately 76% of the population follow this habit, mostly out-of-home, where they are avid consumers of the *bica*⁶³. However, a shift in consumption location pattern is witnessed: from 2009 until 2011 in-home grows from 20% to 24%. This is where coffee capsules grow towards being one of the most preferred types of coffee. (**Page 14**).

Political/legal: The severe conditions in Portugal and its FMCG industry are intensified by a VAT increase of 10% which the government announces to be an effective measure for 2012, in an attempt to recover from the crisis (**Page 6**). This tax adjustment only brings the expenditures of Portuguese households even further, since retailers and manufacturers do not let go of their margins by adjusting prices, in this case above previous levels.

Technological: Technology plays a major role in NDG's success and the single-serve coffee industry in general. It is due to the technological breakthroughs that allowed for a cup of coffee to come out of a small capsule that Nespresso reached the place where it stands today. The patents protecting it for many years finally began to expire and subsequently other brands began investing in this market segment (**Page 10**). As NDG follows its older brother's footsteps, it develops its unique kind of capsule which is then used with the first multi-beverage system in the world (**Page 11**), showing its own creative use of technology incorporated into its value proposition.

⁶³ Bica is a Portuguese expression for espresso coffee.

Company

As part of Nestlé, the leading coffee company worldwide (**See exhibit 7**), on top of being closely related to coffee capsules pioneer Nespresso, NDG naturally inherited a set of competencies which allowed it to become a top performer today. In Portugal, it is the 2nd biggest player in capsules (**See exhibit 1**) and in machines (**See exhibit 11**). The relationship between these two types of products within NDG and its partner Krups must be clearly understood. NDG only profits from selling capsules, even though it designs the machines and defines their entire marketing communications strategy. Krups, on the other hand, is exclusively responsible for manufacturing and selling machines to retailers, consequently collecting their profits (**Page 12**). Its product portfolio comprises a diverse array of machines ranging from €79 to €169, which much like the competition they come in a variety of shapes and colors (**See exhibit 14**). In addition, it consists also of similarly varied assortment of capsules packs, which represent 20 different kinds of beverages, hot and cold ones, including pure coffee, coffee specialties, chocolate flavored and even tea ones (**See exhibit 15**). Indeed, NDG aims to be perceived as a multi-beverage system (**Page 11**). All packs contain 16 capsules and cost €5.21. However, some packs, internally denominated *white cups*, only allow the consumer to make a total of 8 beverages due to the fact that each beverage requires 2 capsules to make (**See exhibit 15**). This is NDG's way of doing price differentiation within its capsules portfolio, as white cups have a higher cost per beverage. NDG is also the first and only brand to sell previously known roast and ground coffee brands in capsules, namely Buondi and Sical, two brands highly familiar to Portuguese consumers (**Page 19**). Regarding distribution and availability of both machines and capsules, NDG was the first coffee capsules brand to be obtainable at modern distribution channel (**Page 11**). At home appliance stores, only machines are available, whereas at hypermarkets and large supermarkets both machines and capsules are sold, and in small supermarkets just the latter (**Page 12/13**). At food retailers, the shelf space is shared with other roast and ground coffee products (**Page 13**).

Collaborators

Krups, a brand specialized in small household electric appliances, is the vital partner responsible for producing NDG's machines (**Page 11**). Consumers cannot experience a NDG beverage without a machine. Therefore, it is imperative that this partnership works as efficiently as possible regarding the way synergies are created

between both brands when outlining the strategy to place a coffee capsule machine inside the homes of Portuguese consumers. Other collaborators in this business are the retailers who put the brand's products available at physical locations attainable for shoppers, whether they supermarkets and hypermarkets or home appliance stores (**Page 12**).

Competition

NDG's main direct competitors are amongst other manufacturers, as well as retailer brands, namely:

Nespresso: The first coffee capsules brand in the world, Nespresso is still the market leader in Portugal, yet it considerably decreases its market share from 2010 to 2011 (**See exhibit 1**). It offers only coffee beverages and the positioning is, since the beginning, a highly premium one, having the quality of its coffee as the main differentiating element (**Page 9**). This fact reflects in both its capsules and machines prices. It has over 20 different coffee flavors, ranging from €3.75 to €4.55 for a pack of 10 capsules. Its assortment of machines is also wide and prices go from €99.99 to €599.99 (**See exhibit 2**). Consumers can obtain Nespresso capsules and machines by visiting the brand's online store or a Nespresso Boutique store.

Delta Q: The coffee capsule system brand owned by Portugal's leading coffee company Delta (**See exhibit 8**), appeared around the same time as NDG (**Page 15**) and today enjoys the 3rd place in coffee capsules market share rankings (**See exhibit 1**). It is also a multi-beverage system, adopting a more mainstream positioning, however bearing a close resemblance to Nespresso's premium strategy (**Page 15**). Delta Q also offers 10 capsules per pack, alternating between €2.99 and €3.29 for each pack, providing nearly 20 flavors of coffee and tea. Its array of machines is varied, selling one for as little as €29, all the way up to €499 (**See exhibit 2**). Regarding distribution, it has the same availability as Nespresso and NDG, being present at modern distribution, online and at its exclusive boutique stores.

Pingo Doce: The first retailer worldwide to introduce a coffee capsule system own brand (**Page 15**). It is 4th in Portugal, being is the fastest growing player (**See exhibit 1**). It is a much more price-conscious oriented brand, selling in packs of 16 capsules, offering 7 different coffee flavors at €3.52 each pack, while having only one machine in its

portfolio at €49 (**See exhibit 2**). Logically, it is only available for purchase at Pingo Doce's stores.

Concerning indirect competitors, even though the case does not focus on them, it is worth mentioning that all other coffee manufacturers selling roast and ground coffee as a substitute to coffee capsules are also threats to NDG's business, especially Portugal's market leader Delta (**See exhibit 8**).

2. Describe NDG's main source of competitive advantage which was vital to achieve its position in the market today.

NDG's main source of competitive advantage should be equivalent to at least one of Porter's four competitive advantage strategies (**See TN exhibit 4**). To decide on which, all four of them should be carefully analyzed.

First of all, it should be concluded on whether NDG has a cost leadership advantage. Is it able to produce and sell its machines and capsules in an efficient way causing it to be more attractive than the competition's offerings? This was true until Pingo Doce came into the coffee capsules market landscape. Its own CCS brand completely disrupted the market in terms of pricing. For instance, it was responsible for dropping the average machine price from €144 to €87 (**Page 15**). A coffee capsule machine was the gateway to capsules consumption and if NDG could not assure this better than its competitors than it could not leverage its position through a cost leadership advantage.

The second source of competitive advantage to consider is differentiation. Is NDG's ability to enhance its position in consumers' minds as a clear and unique value proposition what sets it apart from competitors? Its wide range of capsule varieties and differently designed machines was a sign of innovation (**See exhibit 14 and 15**). NDG aimed to be a true multi-beverage system and indeed it offered a set of beverages that none of its competitors could achieve (**See exhibit 2**). A good example was the exclusive availability of Buondi and Sical capsules (**Page 18**) which consumers admitted to be a differentiating element to the brand.

The third strategy to reflect upon is focus: the ability to target a very specific market niche and ultimately conquer it. The coffee capsules industry was growing two

figures per year (**Page 15**), while it was a niche market when Nespresso first appeared in 2003, it could not be considered like this anymore. Moreover, NDG's purpose was to aim at a broader target (**Page 11**), it did not focus its strategy on delivering its products to a small captive audience, as it clearly wanted to become the most complete multi-beverage system of the market.

Finally, was NDG's strategy a "middle of the road" one? Did it strive to be cost effective, unique and focused all at the same time but achieved none extremely well? From the previous analysis it is clear that NDG's main source of competitive advantage was indeed being able to adopt a differentiation strategy and as a consequence achieve its goals.

3. In the context of sales promotions, identify the activities used by NDG, discuss their objectives, advantages and disadvantages, and provide future recommendations.

Throughout the case NDG is shown to have taken advantage of the following sales promotion activities:

Sweepstakes (**Page 16**): Their main goal is to promote an increase in sales and in brand awareness. They can potentially get major media coverage, favoring brand advertising and often times allowing for cooperation between brands. Yet, they do not have any immediate impact on the consumer and the cost associated with such activity is independent of how many consumers participate.

Temporary price reductions (**Page 16**): This strategy aims to reward loyal consumers, while enticing the disloyal ones. It is known to be highly appreciated by consumers, being simple to implement and the effects are significant if consumers are price sensitive. Nonetheless, it is not adequate for premium brands and if used too often it can potentially damage brand image.

Tasting events (**Page 17**): This technique has the purpose of attracting new consumers by doing one-on-one communication of the brand and also aims at increasing sales. Tasting results in greater resistance to forgetfulness, potentially increasing the

probability of future purchases. However, it can be considered less “generous” when compared to other types of sales promotions.

Point-of-sale materials (Page 17): They have the objective of boosting sales, increase brand visibility and encourage impulse purchases. Visually highlighting products is definitely the great advantage, while it also be used with other promotion mechanics and potentially achieve positive synergies. However, they are usually temporary, depending on how they are negotiated with retailers and they require greater maintenance, constantly needing to be stocked in order to preserve the visual appeal.

Taking into account the available literature, it is possible to make an assessment on how NDG’s choices in sales promotion activities are affecting its performance and whether there is still room for improvement or not. Utilizing the results from the Benefit Congruency Framework of Sales Promotion Effectiveness by Chandon et al. (2000) (**See page 36 and TN exhibit 2**), and assuming NDG as a high-equity brand, due its strong position in the market today, and coffee as a hedonic product (as the author puts it), some conclusions can be drawn. The only monetary promotion used by the brand is a temporary price reduction exclusive to its online store (**Page 16**), whereas nonmonetary promotions are predominant, which is in line with the strategy of avoiding sales promotions whenever possible (**Page 20**), as nonmonetary promotions require less investment by the company and do not affect profitability as much. Surprisingly, monetary promotions destroyed market share in this category, while the opposite occurred with nonmonetary ones. Conversely, Ana Moura’s (1997) study on the Portuguese population shows their preferences lean precisely towards monetary promotions, although the author does not distinguish utilitarian from hedonic products in the analysis. Consumers value promotions that provide them instant and assured benefits.

NDG is correct to use nonmonetary promotions as they seem to offer greater gains in market share, yet Portuguese consumers appear to largely prefer monetary promotions. Combining both studies reveals the need to further investigate the Portuguese situation by means of the methodology employed by Chandon et al., as the former’s conclusions only represent the American and French reality.

4. Identify the reasons behind NDG having decided to launch a differently sized capsules pack. Provide your initial advice to António on which format is the most suitable option.

The financial crisis was the main trigger for the challenging situation where most companies were nowadays. Less purchasing power means consumers spend less and therefore consume less. A consequence of this downfall was a VAT increase from 13% to 23% (**Page 6**). This could only bring the population to an even more fragile condition in terms of managing their expenses. Such an increase in taxes meant that a NDG standard 16 capsules pack went from €4.79 to €5.21 (**Page 19**). Staying at a price-point above €5 could become barrier to consumption, due to the fact that all competitors managed to keep its prices below this line. Subsequently, the best tangible way for companies to fight this harsh setting is to invest in sales promotions, which bring prices down to the final consumer, but also carries lower levels of margins and profitability for firms (**Page 7**). NDG was no exception to the rule, as seen from its recent sales promotion strategy (**Page 19**). As stated by António Sousa, this path was not what he intended for the brand, as it was slowly turning NDG into being promotion driven. At the same time, competitors were extremely active and aggressive in their actions. Even though NDG's sales were still growing, Delta Q's and Pingo Doce's were growing faster (**See exhibit 1**). In the end, a new capsules pack format could potentially cause NDG to significantly recover market share, if the right number of capsules per pack was chosen. At a glance, this can already be a differentiation element for the brand, as most competitors offer 10 capsules per pack, with the exception of Pingo Doce which offers the number as NDG (**See exhibit 2**).

If António is to choose 12 capsules per pack the price per pack will considerably drop to €3.90 (**Page 21**), although the price per capsule will stay at the standard €0.33, the same as with the 16 capsules pack. With 30 capsules the opposite will occur, as the price per pack will rise to €8.89, but at only €0.30 per capsule (**See exhibit 15**). Each possibility offers clear advantages in terms of savings to the final consumer, even though the 30 capsules pack proves to be more cost effective. The issue here is on whether the consumer can interpret this saving or not. Are they going to perceive a lower price-point as an immediate saving, or are they willing to spend more per act of purchase and achieve greater savings in the long run? Results from the market study done on shoppers (**Page 22**) show a preference for the larger pack, as price per capsule is indeed identified as being

more important, hence the cost effective nature of the pack is recognized. The smaller pack, on the other hand is mistaken by a standard pack due to its similar dimensions, and the lower price is incorrectly associated with a price discount over it. Nonetheless, some shoppers reveal that this is a good pack for the end of the month when they do not have so much money to spend. Another possible standpoint that can help deciding between one of the two new formats is the fact that with 12 capsules, NDG compromises the market share gains it set as a goal, considering 30 capsules per pack puts a substantially greater amount of product inside the homes of current and potential NDG consumers, providing them a whole month of coffee supply (**Page 21**).

As a result of a purely qualitative analysis, it can be therefore concluded that 30 capsules per pack is a better option for the new format.

5. For each pack, calculate how many capsules NDG would have to sell in order to achieve break-even point and based on your solution assess which is the better option from a financial point of view. Assume the following data to aid in your answer:

	12 caps pack	30 caps pack
Variable costs	1,08 €	2,70 €
PFME ⁶⁴	300 000 €	750 000 €
Other production costs	0,08 €	0,20 €
% of total capsules retail target		15%
Retailer margin		20%

A manager’s decision making process does not rely only on research and qualitative insights. A product’s financial assessment and viability is an inevitable step to take in order to achieve maximum profitability. Through the available data António Sousa is able to calculate the break-even point for each new pack and conclude which one will return profit sooner.

$$Break - even\ point\ (pack) = \frac{Fixed\ Costs}{Contribution\ Margin}$$

⁶⁴ PFME: Product Fixed Marketing Expenditures.

$$\text{Break – even point (€)} = \text{Break – even point (pack)} \times \text{Selling price (pack)}$$

To begin with, it is necessary to determine the target volume for the new packs, taking into consideration the total capsules target for the retail channel (**Page 21**):

$$\text{Total retail target (capsules)} = 150\,000\,000$$

$$\text{New pack target (capsules)} = 150\,000\,000 \times 15\% = 22\,500\,000$$

Before independently analyzing each option, it must be pointed out the fact that the price per pack referred throughout the case (**See exhibit 17**) includes VAT. Consequently, this tax effect must be removed from the price, since manufacturers and retailers do not take it into consideration during negotiations.

Choosing 12 capsules pack

Retail price w/ VAT	3.90 €
VAT	23%
Retail price w/o VAT	$3.90 \times (1 - 0.23) = 3.00 \text{ €}$
NDG price w/o VAT	$\text{Retail price w/o VAT} \times (1 - \text{Retailer margin}) =$ $3.00 \times (1 - 0.20) = 2.40 \text{ €}$
Target (pack)	$\frac{22\,500\,000}{12} = 1\,875\,000 \text{ packs}$
Total fixed costs	$\text{PFME} + \text{Target (pack)} \times \text{Other production costs} =$ $300\,000 + 1\,875\,000 \times 0.08 = 450\,000 \text{ €}$
Contribution margin (pack)	$\text{NDG price w/o VAT} - \text{Variable costs} =$ $2.40 - 1.08 = 1.32 \text{ €}$
BEP (pack)	$\frac{450\,000}{1.32} = \mathbf{340\,290 \text{ packs}}$
BEP (€)	$340\,290 \times 2.40 = \mathbf{817\,514 \text{ €}}$

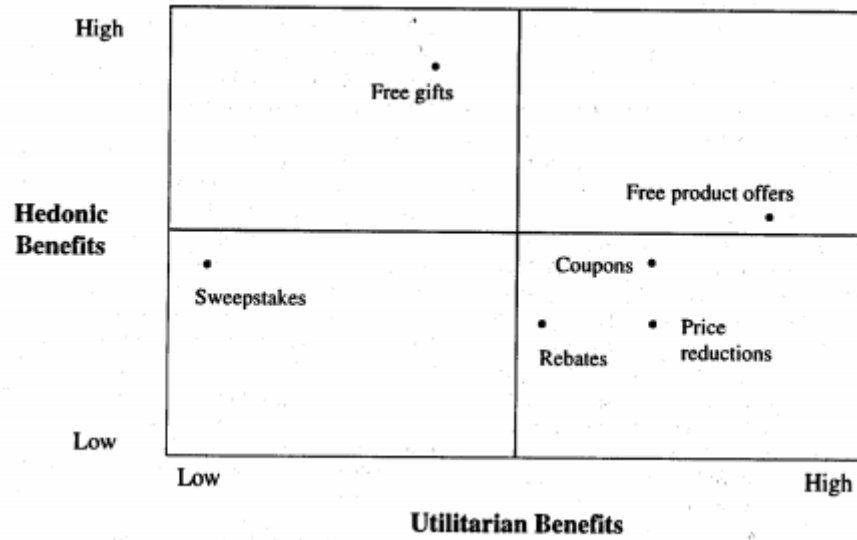
Choosing 30 capsules pack

Retail price w/ VAT	8.89 €
VAT	23%
Retail price w/o VAT	$8.89 \times (1 - 0.23) = 6.85 \text{ €}$
NDG price w/o VAT	Retail price w/o VAT \times (1 – Retailer margin) = $6.85 \times (1 - 0.20) = 5.48 \text{ €}$
Target (pack)	$\frac{22\,500\,000}{30} = 750\,000 \text{ packs}$
Total fixed costs	PFME + Target (pack) \times Other production costs = $750\,000 + 750\,000 \times 0.20 = 900\,000 \text{ €}$
Contribution margin (pack)	NDG price w/o VAT – Variable costs = $5.48 - 2.70 = 2.78 \text{ €}$
BEP (pack)	$\frac{900\,000}{2.78} = \mathbf{324\,179 \text{ packs}}$
BEP (€)	$324\,179 \times 5.48 = \mathbf{1\,775\,285 \text{ €}}$

Even though the 12 capsules pack has considerably lower marketing fixed costs, albeit an also lower contribution margin, the fact that each pack contains only 12 capsules makes the proposed total target significantly higher than the one determined for the 30 capsules pack. As a consequence, this translates into the larger pack being able to start making profit approximately 16 000 packs sooner than the first option. At the end of the day, this outcome gives António and the NDG team full confidence on choosing how many capsules should the new pack contain and the final verdict is undoubtedly 30.

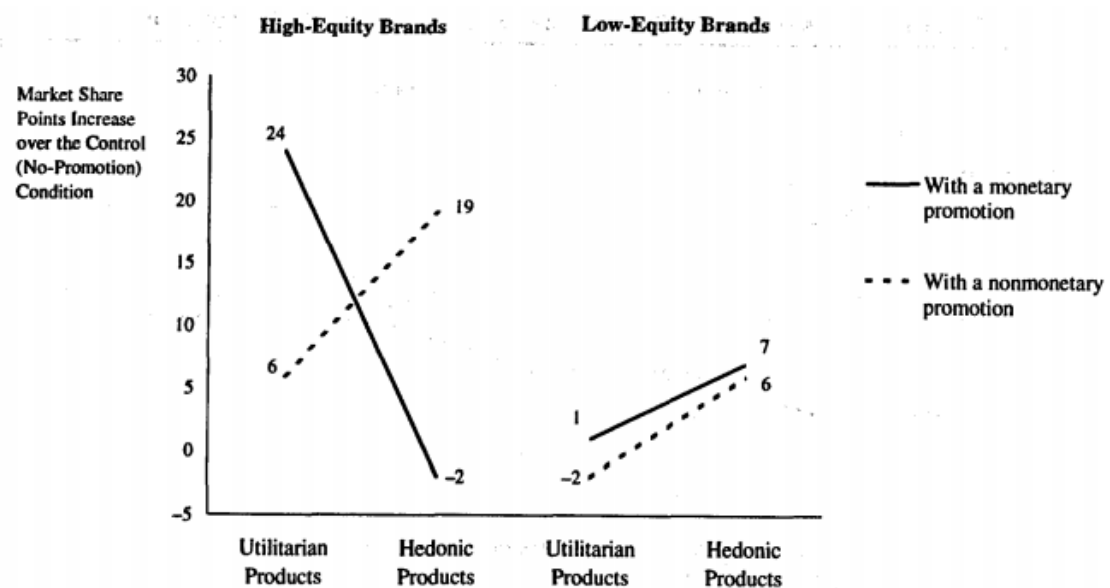
TN Exhibits

TN Exhibit 1 Sales Promotions Benefit Matrix



Source: Adapted from Chandon, P., Wansink, B., Laurent, G., 2000. *A Benefit Congruency Framework of Sales Promotion Effectiveness*. Vol. 64, pp 65-81. Journal of Marketing.

TN Exhibit 2 How Benefit Congruency Influences Sales Promotion Effectiveness



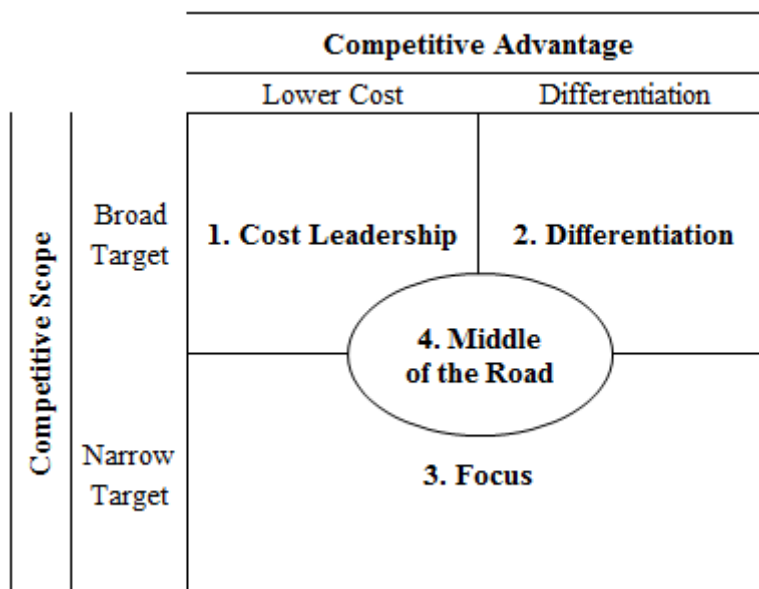
Source: Adapted from Chandon, P., Wansink, B., Laurent, G., 2000. *A Benefit Congruency Framework of Sales Promotion Effectiveness*. Vol. 64, pp 65-81. Journal of Marketing.

TN Exhibit 3 5 C's Analysis

Customers	Context	Company	Collaborators	Competition
Customer needs Segments Consumer behavior ...	Culture Politics Regulations Social norms ...	Brand name Image Production capability Financial strengths Organization ...	Downstream wholesalers or retailers Upstream suppliers ...	Actual or potential Direct or indirect Products and positioning ...

Source: Adapted from Avery, J., Steenburgh, T., 2010. *Marketing Analysis Toolkit: Situation Analysis*. Harvard Business School.

TN Exhibit 4 Porter's Generic Competitive Strategies



Source: Adapted from Porter, Michael E., 1985. *Competitive Advantage*. Ch. 1, pp 11-15. The Free Press. New York.

References

Avery, J., Steenburgh, T., 2010. *Marketing Analysis Toolkit: Situation Analysis*. Harvard Business School.

Chandon, P., Wansink, B., Laurent, G., 2000. A Benefit Congruency Framework of Sales Promotion Effectiveness. Vol. 64, pp 65-81. *Journal of Marketing*.

Kotler, P., Armstrong, G., Wong, V., Saunders, J., 2008. *Principles of Marketing*. Fifth European Edition: Pearson Education.

Moura, A., 1997. *Promotions des Produits de Marque et Comportement d'Achat du Consommateur en Grande Surface: Cas de la Grande Distribution dans la Région de Porto – Portugal*, pp 166-177, Ph.D. Dissertation, Institut Polytechnique de Lorraine, France.

Porter, Michael E., 1985. *Competitive Advantage*. Ch. 1, pp 11-15. The Free Press. New York.