CASE STUDY 4.2

Senseo: creating competitiveness through an international alliance

A brief history of coffee

Coffee was first consumed in the ninth century, when it was discovered in the highlands of Ethiopia. From there, it spread to Egypt and Yemen, and by the fifteenth century had reached Azerbaijan, Persia, Turkey and northern Africa. From the Muslim world coffee spread to Italy, then to the rest of Europe, to Indonesia, and to the Americas.

Coffee has played an important role in many societies throughout modern history. In Africa and Yemen, it was used in religious ceremonies. As a result, the Ethiopian Church banned its secular consumption. It was banned in Ottoman Turkey in the seventeenth century for political reasons, and was associated with rebellious political activities in Europe.

For many decades almost all coffee has been sold as filter coffee in package sizes of one pound (500 grams). However, during the last decade things have changed. New products and package sizes have been introduced. The present case deals with a few of these new innovations. Today coffee has become a popular drink around the world and comes in many variations, both in terms of roasting and of brewing.

Spurred by the strength of coffee bar culture in many developed markets, manufacturers have attempted to increase value sales by introducing a similar 'café experience' at home. The battle among coffee makers for at-home use has intensified, with leading coffee players, such as Procter & Gamble, Kraft Foods and Philips & Sara Lee (Senseo), launching single-service pod machines which can brew a high-quality cup of coffee in less than one minute.

The influence of specialist coffee shops with their speciality coffee products based on the espresso fresh coffee bean has significantly influenced the consumption habits of younger people especially. These consumers increasingly abandoned classic filter coffee and embraced the Italian-American varieties of espresso fresh coffee beans and coffee pods/capsules. The coffee produced by espresso/café crema grinders and pod/capsule machines have two things in common: less caffeine and a milder taste than traditional filter coffee, while providing the 'crema' effect enjoyed by many consumers.

The history and categorization of the coffee maker

Before the coffee maker was invented, coffee was prepared in boiling water. The beans were roasted on an open fire and then added to boiling water for consumption. This process did not bring the desired taste and aroma, and coffee lovers started to devise ways to come up with a machine or a coffee maker that would prepare tasty coffee.

In 1912 Frau Benz invented the Melitta coffee filter, which is an efficient disposal method for coffee. Prior to this, linen or cloth was used for the filtering purpose of coffee.

The coffee maker market can be categorized into roughly three types:

1. Traditional filter machines
2. Espresso machines
3. Pod coffee machines. This is a sector that was actually pioneered by Nespresso, but the market leader now is Senseo. Their growth is driven by their ease of use and affordable pricing – later described in more depth.

These three categories are by no means complete and there are many categories that are not covered here.

A new and innovative filter-type coffee maker was invented in the 1960s and had more advanced features than the earlier varieties. Developed further over time, this new design came to be manufactured by many companies and its demand rose in the market. The leading brands in this market were Melitta and the Mr Coffee brand, which was manufactured with automatic drip process (Joe DiMaggio was its spokesperson from 1974). Today, the Mr Coffee holds a major part of the market share in the world.

An espresso coffee drink gives more energy and it is tastier than the other coffee drinks. The first espresso maker was invented by a manufacturing company owned by Lugia Bezzer in 1901 in Italy. Mr Bezzer was looking for a way to help speed up his employee's coffee breaks and worked out that if pressure was applied in the brewing process, the drink could be made in a lot less time. Nicknamed 'The fast coffee machine', the espresso machine patent was sold in 1905. The new owner, Desidero Pavoni, developed an espresso machine that used a piston pump to force water through a tube and into the coffee.

The commercial espresso machine was invented in 1946. Since then, the espresso maker under different brands has been produced by many companies. Some of the prominent brands include Juda, Mrs Coffee, Kitchenaid and Braun. The modern espresso machine comes in various features, styles, colours and prices.

The world market for coffee machines (coffee makers) looks like this:

Table 1 The global market for coffee machines (2008)

Retail volume (million units)	
Western Europe	17.8
Eastern Europe	0.6
North America	28.4
Latin America and Carribbean	4.1
Asia Pacific (minus Australia and NZ)	2.9
Australia and NZ	0.3
Africa and Middle East	0.7
World total	54.8

Source: adapted from Euromonitor International.

As shown in Table 1, the market volumes vary a lot between the regions. There are also huge differences, within the different world regions. For the Western European market the overall picture for the coffee machine market (divided into the three categories) looks like this:

The number of coffee machines in European kitchens is expected to be 100 million units.

Traditional filter coffee machines have still the highest volume market share (55 per cent). There is a considerable trend towards Espresso full-automatic and an extremely strong trend towards espresso portioned machines. Low-comfort and low-quality machines (hand-operated espresso piston, pad-filters, combis) are losing market share.

Across the western European region, the national markets are very different. Italy, Switzerland and Portugal have a huge market share of espresso machines; over 70 per cent. On the other hand there are countries with a very low market share of espresso machines such as Belgium, Germany or the Netherlands, with less than 20 per cent. In Belgium or the Netherlands pad-filters are quite popular with a market share of about 40 per cent. It is interesting to have a look at the markets in value. Assuming roughly that typical prices are 30 euros for filter machines, 70 euros for pad-filters and 200 euros for espresso machines an opposite picture evolves. Espresso machines are strongly dominating the market in value (see Table 2).

For many decades almost all coffee has been sold as filter coffee in package sizes of one pound (500 grams). However, during the last decade things have changed. New products and package sizes have been introduced. The remaining of this present case deals with one of these new innovations: the single-serve coffee pod system.

The single-serve coffee pod system

While the single serve brewing concept has proved successful in western Europe, particularly the Netherlands and France, the trend is still in its early stages in the US, and is yet to impact most devel-

Table 2 The Western European coffee machine market

Category	Typical brands	Sold units in millions 2008	Typical price € 2008	Value in millions € 2008
Traditional filter machines	Melitta, Mr Coffee	10.0	30	300
Pod coffee machines	Nespresso, Senseo	3.5	70	245
Espresso machines	De Longhi, Jura, Krups and Rowenta, Rotel	4.3	200	860
Total		**17.8**		**€1,405**

Source: adapted from: Jürg Nipkow and Eric Bush: Coffee machines: recommendations for policy design, Report 7 August 2008, Topten International Group TIG, Paris, www.topten.info.

oping markets, where disposable incomes have not reached levels that would sustain demand. However, manufacturers hope that the concept will take hold with American consumers because it allows coffee to be made quickly, cleanly and in small quantities. That said, product choice remains limited, and with 'closed' systems, consumers must stick to buying coffee pods compatible with their single-serve machine.

As consumers face growing choices of new style coffee makers for home use, one of the deciding factors could be the availability of pods. After consumers have made their machine choice, probably based on price and the physical aspects of each machine, having easy access to the coffee pods themselves will be key. Flexibility may also turn out to be a competitive advantage. In addition to coffee, the Tassimo system allows consumers to make hot chocolate or tea, a feature rival Senseo offers only on upmarket models with specially purchased pods. On the other hand, Melitta One:One decided that the battle for pod control could only be won by revamping its pods to fit both its own system and those machines marketed by competitors.

Coffee pods and capsules largely imitate the benefits of freshly prepared espresso/café crema with the added benefit of convenience. They require less preparation time and offer standard one or two cup sizes, which appeal to single people. This segment has grown a lot to account (in Germany, for example) for 10 per cent of retail value sales of fresh ground coffee in 2008. Due to the much higher unit prices of coffee pods, it accounted for only just over 5 per cent of retail volume sales of fresh ground coffee in the same year.

Senseo

The basis for the success of coffee pods was provided in 2001, when Philips introduced coffee pod machines under the Senseo brand. These machines are geared towards the use of coffee pods produced by Douwe Egberts.

So the Senseo coffee pod system is the result of a partnership between electronics expert Philips (supplier of the Senseo machine) and coffee roaster Douwe Egberts (supplier of the coffee pods) – both world-renowned companies from the Netherlands. Coffee pods are tiny packages weighing 5–10 grams. A traditional bag contains 25 pods – a pod is put into the machine and within 45 seconds or so it transforms into one up of coffee (0.15–0.25 litre).

The two alliance partners

Philips

Royal Philips Electronics of the Netherlands (NYSE: PHG, AEX: PHI) is a diversified health and well-being company, focused on improving people's lives through timely innovations. As a world leader in healthcare, lifestyle and lighting, Philips integrates technologies and design into people-centric solutions, based on fundamental customer insights and the brand promise of 'sense and simplicity'.

Headquartered in the Netherlands, Philips employs more than 118,000 employees in more than 60 countries worldwide. With sales of €26 billion in 2008, the company is a market leader in cardiac care, acute care and home healthcare, energy efficient lighting solutions and new lighting applications, as well as lifestyle products for personal well-being and pleasure with strong leadership positions in flat TV, male shaving and grooming, portable entertainment and oral health care.

Sara Lee/Douwe Egberts (DE)

Douwe Egberts was founded in the middle of the eighteenth century by the Dutch entrepreneur Egbert Douwes and his wife Akke Thysses. The company's activities included coffee, tea and household and body care products. Soon they developed a reputation regionally by also supplying shop owners elsewhere, thereby spreading the Douwe Egberts brand around the country. Gradually, Douwe and his descendants built a company that grew to become the Dutch market leader for its core products, coffee and tea. Since 1978 Douwe Egberts has been owned by the Sara Lee Corporation, which opened new horizons worldwide. Today Douwe Egberts is the second largest coffee roaster in the world and the company employs over 26,000 people worldwide.

The company prospered, and continued to grow throughout The Netherlands, but it was not until the mid-twentieth century that it expanded beyond the borders of its homeland. In 1948, Douwe Egberts began selling coffee, tea and tobacco in Belgium. Over the next 20 years, the company added sales in Belgium, France and Spain. In 1978, the company was acquired by international food corporation Sara Lee. Since then, Sara Lee and Douwe Egberts has become the second largest coffee roaster in the world. Familiarly known as Sara Lee/DE, the company is a subsidiary of Sara Lee and employs over 26,000 people around the world.

The Douwe Egberts brands include Pickwick tea, Douwe Egberts coffee, Piazza d'Oro espresso, Cafitesse, Pilao coffee and of course, the Senseo system. Sara Lee sells products in nearly 200 countries. The Sara Lee brands include Sara Lee, Earth Grains, Hillshire Farm, Jimmy Dean, Ball Park, Bimbo, Kiwi, Ambi Pur, Sanex and of course, Douwe Egberts.

Sara Lee/DE's part of the partnership is, of course, coffee. Douwe Egberts offers a wide variety of coffee blends to suit most tastes, as well as tea in pods to fit the Senseo machine. The current blends include Sumatra, Brazil, Kenya and Colombia, each of them with the characteristics common to the named region. In addition, there are selected specialty beverages, including espresso, cappuccino and Café Noir, a sweet, dark blend with a chocolate finish. There are also flavoured pods, which include Paris (vanilla caramel), Vienna (hazelnut, vanilla and mocha), and a number of limited edition varieties that are currently only available in select European locations. For tea lovers, Douwe Egberts offers Earl Grey and minty green T-pods for the Senseo.

In 1998, Sara Lee/DE filed a patent in Belgium to protect their use of the coffee pod system. When the Senseo hit the market and competitors realized that the patent prevented them from manufacturing coffee pods the patent was successfully challenged in the Belgian court. As of 2004, the year that the Senseo was introduced in the US, other companies have the legal right to make and sell coffee pods that fit the Senseo system. In addition, several pod-makers on the market allow consumers to make their own coffee pods. This allows flexibility in making the coffee or tea of your choice utilizing the Senseo brewing system.

Philips and Douwe Egberts

Working in tandem, the two companies developed every aspect of Senseo – from its patented coffee machine and the brewing process to its one-of-a-kind coffee pods. The machine uses single portion Senseo coffee pods, containing the finest ground coffee, to guarantee a perfect cup every time it is used. Senseo has now been launched in more than a dozen countries worldwide. The biggest markets are Austria, Australia, Belgium, China, Denmark, France, Germany, the Netherlands, UK and US.

Since Philips and Douwe Egberts introduced the coffee pod machine in spring 2001 it has sold more than 15 million coffee machines and more than 8 billion coffee pods in the first seven years of its life time. It is estimated that over five million coffee pod machines were sold in Germany by mid-2007. As coffee made from coffee pod machines is very expensive when consumed in large quantities, these machines are used as an additional coffee option rather than as a replacement for standard coffee machines. The typical owner of a coffee pod machine is young (40 years old and under), but owners include single people, couples and adults with small children.

When the Senseo coffee pod machine was introduced the end-user price was around €75: the current recommended price is €69, but in spring 2009 it was available for around €58.

It is reported that almost one-third of Dutch households own a Senseo machine, and the figure is expected to climb steadily in the years to come. Although most Dutch households continue to use both conventional filter coffee machines and single-serve coffee systems, unit sales of the latter in recent years have outperformed the former. Nevertheless, industry experts suggest that it will take a long time for conventional filter machines to disappear completely (just as it took a lot of years for colour TV to supersede black and white TV or DVDs to oust VHS). Many Dutch households are expected to continue to use conventional machines when holding a party and the Senseo-type machines for everyday use. The consumption behaviour of Dutch households is suggested to be a rough model of the average household within the EU.

Competitive advantages of Senseo

Low-cost followers from China, used to selling cheaper filter coffee machines, have had problems catching up on this alliance, because they cannot easily copy the tight collaboration between Philips and Sara Lee's Douwe Egberts subsidiary that produces the coffee packets designed especially for the Senseo machine.

When big retail chains like Aldi and Wal-Mart see a product like this, they usually go to China and ask for something similar. In the Senseo-case it is not so easy, because the main profits from the Senseo concept come partly from coffee machines but mainly from coffee pods. This makes life difficult for the Chinese competitors who have to recoup that money from machines alone.

Presently the market price for a traditional cup of filter coffee lies somewhere between 4 and 5 euro cents, whereas the price of a cup of pod coffee (7–10 grams) varies between 16 cents (Senseo) and 30–32 cents (Nespresso and Tchibo). Thus, for obvious reasons, coffee producers are very interested in the 'sky high' profit margins of the pods compared to the ruinous price levels of the traditional coffee package sizes (400 and 500 grams). The strategy of developing mini-packages (where the kilo price is much higher) represents a current retail trend. For instance the German candy producer Haribo has for some time sold a unit package containing 10–25 mini-packages.

Once the pods were introduced, no one had the slightest idea that this market niche would develop so fast and be so successful. While the competition in the ordinary coffee market continues to be as fierce as ever, the price competition in the pod market, while present, appears to exist in a different world. It seems that many consumers do not 'think' in unit or kilo prices.

As an industry executive recently remarked: 'Suddenly it has become possible to earn money by simply selling coffee.' For a generation or so coffee has been a typical discount product. In a lot of European markets, traditional coffee has been used by retailers (supermarkets, discount stores) as a promotional tool for generating store traffic. In TV ads and sales fliers specific brands are often on promotion and the retailer is losing money on the promoted coffee brand. However, once the consumer enters the store to buy the brand they will normally continue shopping in the same retail store and buy a lot of products that are not on promotion, thereby more than compensating for the loss generated by the promoted brand.

In 2004 the German Market of pods was 2,750 tons (30 per cent up from 2003). Senseo alone sold 650 million pods. The same year Nestlé globally sold 1.3 billion pods (34 per cent up from 2003). During 2003 and 2004 Philips sold two million Senseo coffee machines. When Tchibo launched its Cafissimo machine the 60,000 units available were sold within two days! Because the machines are sold below production prices (€69–99), the producers of the machines are being compensated by the coffee producers. For instance, Philips obtains a part of the profit generated by the sales of the Senseo pods.

Instead of bringing in two constituent brands (Philips and Sara Lee) to create a third brand (Senseo), the alliance team introduced a co-branding strategy, leveraging the equity in the Douwe Egberts and Philips brands to give credibility to the new composite brand, Senseo, forming a separate and unique product, thus ensuring single-minded focus.

Creating an overall identity that transparently links the coffee and appliance as part of one lock-and-key system, and building consumer intimacy around this, was a crucial building block to success, something from which our local equivalent can learn.

Not only has this alliance brought an innovation to consumers, Douwe Egberts and Philips have benefited from creating a new segment within coffee and coffee machines.

You have to ensure that both partners are aligned behind the collaboration, that the key people involved in managing the collaboration have the personal skills to make the collaboration a success, and that a sound co-branding strategy exists for the new product. In addition, there must be a commitment in funding that allows the partners to fully exploit the new product to the target market, creating demand and thus ensuring trade support. Creating a new category through shifting consumer behaviour requires a long-term commitment and an investment strategy to match. In the USA alone, for every dollar Procter & Gamble Co. and Sara Lee have reaped selling coffee for their 'revolutionary' single-cup systems, they have spent three on marketing.

Invariably there will always be issues around the area of intellectual property, and financial arrangements. In the case of the Senseo collaboration, it was agreed that Philips would hold the intellectual property for the coffee machine, whilst Douwe Egberts would retain it for the coffee. In order to ensure that Philips were aligned to view Senseo as a longer-term proposition, Douwe Egberts allowed Philips a share of royalties in the Senseo coffee brand.

Senseo.

A new model of the Senseo machine – the Senseo New Generation – was launched in selected markets in 2007. This updated version allows the user to adjust the height of the mechanism to accommodate larger cups or mugs, has an indicator light function which shows when there is insufficient water for two cups (as opposed to the previous model which only showed whether there was sufficient water left for one cup), features a larger water reservoir and has an option which allows the user to adjust the amount of hot water used per cup.

Competition is emerging

Following the success of Senseo, other branded manufacturers and the leading discounters copied Douwe Egberts's coffee pods and introduced their own for Senseo machines. The pod machines were also copied.

The battle among coffee makers for at-home use intensified in 2005. As a result of the growing competition from me-too products, Douwe Egberts started to seek legal protection for its coffee pods and it tried to prohibit the distribution of the me-too coffee pods. However, in 2006, the European patent covering the Senseo pods was completely revoked on appeal by the European Patent Office. Following the success of Senseo, the leading coffee companies jumped on the bandwagon and introduced not only their own coffee pods but also a similar system based on capsules. In 2005, Tchibo introduced a machine and capsules under Cafissimo, Kraft Foods/Braun introduced Tassimo and, in September 2006, Nestlé and the machine manufacturer Krups introduced Dolce Gusto to Germany.

Unlike the Nespresso system, which has been on the market for over ten years and is positioned as a top-end premium product, Dolce Gusto is a mass product and, like most products by Nestlé, it offers extra amounts of milk foam. All of these new systems are 'closed' systems, which means, for example, that consumers can only use capsules manufactured by Tchibo together with the 'Cafissimo' machine. However, most of the leading brands continue to offer coffee pods that can be used in the Senseo and similar machines.

The only temporary loser in this game was Melitta Unternehmensgruppe Bentz KG, which introduced the 'MyCup' coffee pod system in autumn 2004, as its differently shaped pods were not compatible with the coffee machines of other manufacturers. Consumers refused to buy these coffee pods and Melitta temporarily withdrew its coffee pod system. It launched universal coffee pods in the beginning of 2007 but also kept the differently shaped 'MyCup' pods in its range. At the same time, Melitta launched another product: empty pod sachets that can be filled with coffee chosen by the consumer, significantly reducing the cost per cup. However, as these sachets are awkward to handle, it is uncertain if they will catch on with consumers.

Private labelling – for example in Germany

In Europe, private label plays an ever increasing role in coffee pods, especially in Germany. Here the private labels accounted for over a 45 per cent share of retail volume sales in 2008, as many German consumers remain extremely price conscious. In the traditional fresh ground coffee category, private label accounted for a 33 per cent share of retail volume sales in 2008.

The discounter Aldi continues to play a major role in private label in all coffee categories. In 2008, Aldi led in coffee pods (25 per cent share of retail volume sales) and whole coffee beans (18 per cent retail volume share). Only in traditional fresh grounded coffee are the giant branded player Kraft Foods and Tchibo ahead of Aldi in terms of retail volume shares.

The continued success of Aldi is not simply due to low prices. In 2006, Aldi's fresh ground coffee and coffee pods were rated as 'very good' by the leading consumer magazine, *Stiftung Warentest*. In fact, Aldi's coffee pods came out on top, ahead of more premium and more expensive branded products. Quality is very important to German consumers, who are prepared to search for tasty products at low prices.

QUESTIONS

1. What are the key success factors in this industry?
2. Explain how the competences represented in the Senseo concept can create international competitiveness.
3. Which threats is Senseo facing in the future sales of its product concept?
4. Which new markets are relevant for Senseo to enter?

Sources: Senseo (www.senseo.com); Philips (www.philips.com); Euromonitor International (www.euromonitor.com); Nipcow, J. and Bush, E. (2008) Coffee Machines: recommendations for policy design, 7 August, Topten International Group Report (www.topten.info).

VIDEO CASE STUDY 4.3 Nike

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Nike (www.nike.com) is the largest seller of athletic footwear and athletic apparel in the world. Nike's strategy for growth around the globe is to develop greater reach into diverse market segments. The three main segments are (1) performance athletes, (2) participant athletes, and (3) those that influence the world and the culture of sport. Partnerships are formed with athletes not just because of their status, but also because they are integral in the product development process. For example, to increase market share in Europe, Nike needed to produce a strong soccer product, which it did with the help of star soccer players.

Questions

1. Discuss how Nike's growth can be attributed to its targeting of diverse market global segments.
2. How did Nike penetrate the European soccer footwear market?
3. What are the key driving forces behind Nike's international competitiveness?

For further exercises and cases, see this book's website at **www.pearsoned.co.uk/hollensen**

Questions for discussion

1. How can analysis of national competitiveness explain the competitive advantage of the single firm?
2. Identify the major dimensions used to analyse a competitor's strengths and weaknesses profile. Do local, regional and global competitors need to be analysed separately?
3. How can a country with high labour costs improve its national competitiveness?
4. As the global marketing manager for Coca-Cola, how would you monitor reactions around the world to a major competitor such as Pepsi?

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