

## **THE ESPRESSO LANE TO GLOBAL MARKETS**

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*Ilan Alon and Meredith Lohwasser wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.*

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“Espressamente is all about a perfect shot of dark elixir . . . Espresso is a miracle of chemistry in a cup.”  
Andrea Illy, CEO of Illycaffé S.p.A.

The global coffee industry was booming. From October 2010 to September 2011, world coffee exports increased by 9.4 per cent to 103.1 million 60-kilogram bags.<sup>1</sup> The International Coffee Organization stated, “Demand prospects for coffee continue to be promising, particularly given the growth of niche markets in traditional consuming countries and the arrival of new consumers in emerging markets and exporting countries.”<sup>2</sup> Christophe Reale, managing director of Espressamente at Illy, contemplated Espressamente’s place within the global market and the company’s future growth opportunities. He knew that a global route to market meant prioritizing markets, but where did the greatest potential for success lie? And what kind of strategy should he pursue to take Espressamente to market?

### **ILLY**

Founded in Trieste, Italy, and inventor of the precursor to the espresso machine, Illy marketed a unique blend of coffee drinks in over 140 countries and in more than 50,000 high-end restaurants and coffeehouses. Over six million cups of Illy espresso were consumed every day. In Italy, Illy coffee is widely recognized as the best coffee and is a “must have” in Italian restaurants. Over time, Illy became known as a company based on quality and espresso culture. The company focused on premium travel, business-to-business operations, fashion and culture.<sup>3</sup>

Illy was well known for producing the world’s finest tasting coffee, which it accomplished through quality obsession and knack for innovative design. After beans were purchased, Illy-branded 60-kilogram bags of coffee beans were shipped to Italy; bags were placed in shipping containers to maximize air circulation, which reduced the risk of mould, condensation and unwanted odours. In Italy, the bags were

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<sup>1</sup> International Coffee Association, “Monthly Coffee Market Report,” [www.ico.org/documents/cmr-0911-e.pdf](http://www.ico.org/documents/cmr-0911-e.pdf), accessed on February 13, 2012.

<sup>2</sup> *Ibid.*

<sup>3</sup> *Espressamente Illy Company Report*, 2011.

handled by an automated system and sophisticated machinery. “The last selection is conducted by six bi-chromatic systems which electronically photograph each bean, detecting and eliminating any which do not meet strict color standards — an indication that the bean is not fully ripe, or is a ‘stinker,’ a fermented bean that can ruin a whole batch.” If a bean was defective, it was removed, as were the beans that surrounded it. Illy’s approach was one of zero defects.<sup>4</sup>

Illy built its brand upon its decadent coffee but expanded its product lines over time to include espresso machines, cups and mugs.

### ESPRESSAMENTE

Born in Illy’s unique Italian heritage, Espressamente was the company’s own franchised coffee bar with 200 locations in over 30 countries. It served transit retail markets and began to expand to premium retail markets. Espressamente, meaning “clearly” or “expressly” in Italian, was meant to “purvey the original Italian cult of espresso.” CEO Andrea Illy wanted to create “an exclusive destination with an emphasis on quality and aesthetics. The Espressamente experience will be oh-so-Italiano, focused on coffee served short and dark with the perfect crema, or foam, in a designed demitasse.”<sup>5</sup> (See Exhibit 1.)

In its 2010–12 strategic plan, Espressamente stated that its goals were to be “recognized as the only authentic Italian bar chain delivering superior customer satisfaction to premium transit coffee lovers,” to be profitable and to become a strong stand-alone brand. To achieve these goals, the company first focused on premium transit, retail and service partners instead of private dealers, as well as consistency development. In addition to premium transit locations, the company added luxury retail stores.

### THE GLOBAL COFFEE INDUSTRY

Coffee, after oil, was the most heavily traded commodity in the world.<sup>6</sup> As of 2005, coffee sales each year amounted to over US\$70 billion. The International Coffee Organization emphasized that “the importance of coffee to the world economy cannot be overstated.” Recently, demand had grown in both developed and emerging markets. Specialty coffee was projected to increase worldwide; in the United States alone, specialty coffee sales were forecasted to increase by 20 per cent each year.<sup>7</sup>

Coffee sales across the globe were greatly affected by disposable income and the general economic environment: “Coffee manufacturers depend on a healthy economy and strong consumer spending to drive sales, as consumer spending drives demand for higher priced specialty products.”<sup>8</sup> As the middle class grew in emerging markets, so did prospects for a successful coffee market where the expectation for a premium product was particularly strong. Additionally, the coffee market was characterized by high saturation and aggressive competition. In developed nations, there were thousands of coffee shops, both chains and independents, that competed for space. As a result, many of the larger retail chains looked to international expansion for growth. Emerging markets with growing middle classes, such as in China and India, were experiencing high competition among coffee retailers as Western companies expanded.

<sup>4</sup> [www2.illy.com/wps/wcm/connect/us/illy/](http://www2.illy.com/wps/wcm/connect/us/illy/), accessed February 17, 2012.

<sup>5</sup> “Basta with the Venti Frappuccinos,” *Bloomberg Businessweek*, 2006,

[www.businessweek.com/magazine/content/06\\_32/b3996057.htm](http://www.businessweek.com/magazine/content/06_32/b3996057.htm), accessed February 13, 2012.

<sup>6</sup> Global Exchange, “Coffee FAQ,” [www.globalexchange.org/fairtrade/coffee/faq](http://www.globalexchange.org/fairtrade/coffee/faq), accessed February 14, 2012.

<sup>7</sup> NACS Online, “Fact Sheets: Coffee Sales,”

[www.nacsonline.com/NACS/News/FactSheets/MerchandiseandServices/Pages/Coffee.aspx](http://www.nacsonline.com/NACS/News/FactSheets/MerchandiseandServices/Pages/Coffee.aspx), accessed February 14, 2012.

<sup>8</sup> First Research, “Industry Profile: Coffee Shops,”

<http://search.proquest.com.ezpprod1.hul.harvard.edu/abicomplete/docview/192463238/fulltextPDF/1321075EF8488208B4/1?accountid=11311>, accessed February 14, 2012.

Although there was still room for growth in these markets, competition was aggressive. High levels of competition in the premium coffee industry forced players such as Starbucks, the Coffee Bean & Tea Leaf, Costa Coffee and independent coffee shops to continually innovate and adapt their products and offerings to compete in these concentrated and saturated markets.

A variety of environmental and legal issues surrounded the coffee industry as well. Sustainable coffee production and human rights issues that affected the supply side of coffee became essential to the future of the industry. The world coffee market was characterized by a coffee paradox: there was a “coffee crisis in producing countries with trends towards lower prices and declining producer incomes” while there was a coffee boom in consuming countries characterized by rising sales and profits for retailers. Suppliers had very limited power; in 2005, when coffee sales amounted to over \$70 billion, producers only received about \$5 billion.<sup>9</sup> Some legal issues arose as a result of increased coffee sales in emerging marketplaces. For example, developing nations had fewer laws related to copyright and other regulatory measures.

## COMPETITORS

The coffee industry was highly competitive. Espressamente’s main competitors worldwide included Starbucks, McDonald’s McCafé, Costa Coffee, Lavazza, Tchibo, Segafredo and the Coffee Bean and Tea Leaf. Each had different competitive advantages, and all continued to expand internationally (see Exhibit 2).

Reale considered international expansion and, based on an analysis of Illy sales (see Exhibit 3), internal analysis of documents, executive knowledge of external markets and sales potential, decided to focus on the markets with the highest potential: Brazil, China, Germany, India, Japan, the United Kingdom and the United States.

## BRAZIL

Brazil, the largest grower of coffee in the world, was the second largest consumer coffee market behind the United States. Coffee consumption in Brazil rose rapidly “in line with increased interest in premium varieties and the opening of new, American-style coffee shops,” which presented opportunities for coffee retail companies. Brazil was one of the fastest growing markets by sales in the specialty coffee shops industry, with growth rates always exceeding 30 per cent.<sup>10</sup> Additionally, the coffee market in Brazil was one of the most dynamic in the world and increasingly attracted foreign direct investment.<sup>11</sup> Starbucks was highly successful in Brazil, highlighted by the growing demand for higher value gourmet coffee varieties. It was projected that the continuation of this trend meant that value sales would increase at a faster rate than volume sales over the next five years.<sup>12</sup>

Although consumption was rising due to a larger and wealthier middle class, consumption per capita was still quite low compared to mature markets. Despite this, it was possible that Brazil would overtake the United States in terms of overall coffee consumption sometime in the next few years as increased wealth in Brazil drove a rise in locals’ thirst for espressos and cappuccinos.<sup>13</sup> As the eighth largest economy in

<sup>9</sup> Geoff Riley, “Market for Coffee,” <http://tutor2u.net/economics/revision-notes/as-markets-coffee.html>, accessed February 17, 2012.

<sup>10</sup> Business Monitor International, “Brazil: Food & Drink Report Q4,” <http://search.proquest.com.ezproxy.rollins.edu:2048/abicomplete/docview/904728262/fulltextPDF/1338989D72E3BF732FE/>

<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

<sup>13</sup> Ibid.

the world, Brazil weathered the global economic crisis well and positioned itself as a regional and global power; it is expected to grow to become the fifth largest economy in the next five years. Growth in exports and social programs lifted tens of millions of Brazilians out of poverty, and a majority of the population became a part of the middle class. As a result, purchasing power parity increased dramatically, and domestic consumption became a driver of Brazilian growth.

Brazil's franchise sector was growing on a large scale: in 2010, 1,855 franchises operated 86,365 units and employed 777,285 people.<sup>14</sup> Only 11 per cent of franchises were foreign-based franchisors and there was "natural fierce sector competition."<sup>15</sup> Entering the Brazilian market meant localizing products and services to better compete in a market in which the strength of local brands was a major challenge. Foreign-based franchisors developed relationships with non-competing businesses because of the challenge of finding suitable master franchisees in Brazil; additionally, joint-venture partnership tended to appeal to Brazilian partners because it meant risk was divided between the two partners.<sup>16</sup> "Breaking into this market requires thorough research on the viability and uniqueness of the services and products."<sup>17</sup>

Brazil's capital, Brasilia, was approximately 9,054 kilometers away from Rome, Italy. The flight time from Brasilia to Rome was approximately 12 hours.

## CHINA

China's beverage industry was one of the country's fastest growing sectors. Tea and coffee were established product categories there and were expected to experience modest growth between 2011 and 2015; coffee consumption was projected to increase at a compound annual average growth rate of 10.7 per cent. "The relatively modest growth forecasts can be attributed to the saturated and mature nature of the market."<sup>18</sup> Despite saturation and maturation, large coffee industry players such as Starbucks, China Resources Enterprise and Gourmet Master had plans for aggressive expansion "to capitalize on the growing café culture in China."<sup>19</sup> Coffee drinkers in China often enjoyed food while they drank coffee, which resulted in minimal to-go sales. However, on-the-go consumption of coffee was increasing.

Historically a tea drinking culture, coffee had become an established product category as well. China boasted a huge population, 43 per cent of which lived in urban areas. After the economic downturn, "consumption's role in the economy declined even though real wages increased in China 12.5% a year for a decade . . . "<sup>20</sup> As a result, the country experienced decreasing rates of consumption. Despite the threat of decreased consumption, "rising consumer income and increasing standards of living, as well as the awareness of better-off lifestyles, especially among the growing number of middle-class consumers, have boosted the demand for high-quality products."<sup>21</sup>

<sup>14</sup> Brazilian Franchise Association, "Economic Impact in Brazil Reaches New Heights in 2010," [www.franchise.org/uploadedFiles/Economic%20Impact%20in%20Brazil%20Reaches%20New%20Heights%20in%202010.pdf](http://www.franchise.org/uploadedFiles/Economic%20Impact%20in%20Brazil%20Reaches%20New%20Heights%20in%202010.pdf), accessed February 17, 2012.

<sup>15</sup> Paulo Rodrigues, "Brazil: Franchising," <http://franchise.org/IndustrySecondary.aspx?id=45562>, accessed February 17, 2012.

<sup>16</sup> Ibid.

<sup>17</sup> Bachir Mihoubi, "Dealing with the Complexities of International Expansion," [www.franchise.org/Franchise-Industry-News-Detail.aspx?id=53325](http://www.franchise.org/Franchise-Industry-News-Detail.aspx?id=53325), accessed February 17, 2012.

<sup>18</sup> Business Monitor International, "China: Food & Drink Report Q1," <http://search.proquest.com.ezproxy.rollins.edu:2048/abicomplete/docview/887119018/13245EC23682C2987CC/20?accountid=13584>, accessed February 14, 2012.

<sup>19</sup> Ibid.

<sup>20</sup> Ibid.

<sup>21</sup> International Trade Centre, "The Coffee Sector in China," [www.intracen.org/WorkArea/DownloadAsset.aspx?id=37584](http://www.intracen.org/WorkArea/DownloadAsset.aspx?id=37584), accessed February 17, 2012.

The complex nature of conducting business in China resulted in the establishment of foreign companies through partnerships or master franchising. In 2007, the Chinese Ministry of Commerce changed and clarified many laws that made doing business difficult for foreign companies. Importantly, the “two-plus-one-requirement stipulating that prospective franchisors own at least two directly operated outlets in China for at least a year” was amended.<sup>22</sup> Although China was slowly changing, franchising there was still complicated: “The concept is still new to China with many Chinese unfamiliar with it. Moreover, collecting royalty payments from your mainland franchisee and ensuring that the franchisee maintains the integrity of your brand is also a challenge.”<sup>23</sup> Additionally, foreign franchisors were not allowed to directly purchase real estate property located in China unless it was for personal use. In 2008, China had 3,500 franchised businesses and more than 300,000 franchisees.<sup>24</sup>

As a result of the complexities of running a business in China, importance was placed on establishing different regional partners to successfully and respectfully navigate the Chinese coffee market. Partnerships also allowed companies to gain insights into Chinese tastes and preferences. Additionally, cafés were frequented by young, affluent, fashion-conscious, urban Chinese, as well as expatriates and foreign travelers. Chinese patrons of premium coffee shops preferred lattes, cappuccinos and mochas to espressos, which they considered bitter. Finally, Chinese frequented coffee shops for music and ambience, branded wares and the variety of fresh pastries and cookies offered and were usually business people in meetings, friends meeting or couples on dates.<sup>25</sup>

China’s capital, Beijing, was approximately 8,147 kilometers away from Rome, Italy. The flight time from Beijing to Rome was approximately 11 hours.

## GERMANY

Coffee was an established product in Germany, which ranked second in the world in pounds per coffee consumed per person. Per capita consumption of coffee in Germany had been in decline over the past 15 years, in part due to the “unfashionable and unhealthy” product reputation it held. This trend had recently begun to change due to the rise in popularity of specialty coffee and an increase in U.S.-style coffee chains. “The German Coffee Association reported a shift in consumer behavior, with a clear trend toward the fresh preparation of specialty coffee.” In 2010, average German coffee consumption was 150 litres per person. Business Monitor International predicted that the coffee industry in Germany would grow by 10.5 per cent between 2011 and 2015. It was possible that this growth will be inhibited by continued world economic difficulties; however, it was not affected in 2009 when espresso drinks and single portion coffee drinks demonstrated strong growth.<sup>26</sup> The German coffee industry was characterized by fierce competition and high concentration.

Germany had about 1,000 franchise systems that operated 64,000 units with the help of 470,000 employees.<sup>27</sup> The German Franchise Association had a great deal of power; although it was only partly

<sup>22</sup> U.S. Commercial Service, “Country Commercial Guide, China,” [www.buyusainfo.net/docs/x\\_8054544.pdf](http://www.buyusainfo.net/docs/x_8054544.pdf) accessed May 13, 2012.

<sup>23</sup> Ibid.

<sup>24</sup> Beijing Tian Yuan Law Firm, “Franchise 2011: China,”

[www.franchise.org/uploadedFiles/Franchise\\_Industry/F2011Chinachapter.pdf](http://www.franchise.org/uploadedFiles/Franchise_Industry/F2011Chinachapter.pdf), accessed February 17, 2012.

<sup>25</sup> International Trade Centre, “The Coffee Sector in China,” [www.intracen.org/WorkArea/DownloadAsset.aspx?id=37584](http://www.intracen.org/WorkArea/DownloadAsset.aspx?id=37584), accessed February 17, 2012.

<sup>26</sup> Business Monitor International, “Germany: Food & Drink Report Q4,” <http://search.proquest.com.ezproxy.rollins.edu:2048/abicomplete/docview/888214090/13516D7A0CB767B9CA9/4?accountid=13584>, accessed February 14, 2012.

<sup>27</sup> Heiko Stumpf, “Franchising in Germany,” [www.franchise.org/uploadedFiles/Franchise\\_Industry/International\\_Development/Country\\_Profiles/GTAI\\_FranchisinginGermany2011.pdf](http://www.franchise.org/uploadedFiles/Franchise_Industry/International_Development/Country_Profiles/GTAI_FranchisinginGermany2011.pdf), accessed February 24, 2012.

recognized by the courts, membership in the association was regarded as an indication of quality for a reputable franchise business.<sup>28</sup>

Germany's capital, Berlin, was approximately 736 kilometers away from Rome, Italy. The flight time from Berlin to Rome was approximately two hours.

## INDIA

Although historically known for its tea culture, India was the sixth largest producer of coffee in the world. Interest in coffee in India, particularly the transition to sophisticated coffee bars, began in the 1990s. Specialty and gourmet coffee shops increased in prominence for a few important reasons: first, Indians had increased exposure to international lifestyles and global trends; second, income rose and a middle class emerged; third, there was an increase in disposable incomes as well as in the number of working women; and fourth, the number of young people grew significantly.<sup>29</sup> "Historically, Indians showed little interest in coffee, but changing lifestyles and the rise of high-end coffee shops increased consumption. Companies such as Café Coffee Day, one of the best known coffee shop brands in India, extended upward to target upper income consumers. Coffee consumption was likely to expand at a rapid rate . . ."<sup>30</sup> In 2002, there were 200 cafes in India holding sales of \$10 million compared to 1,500 shops in 2011. Coffee consumption in India had increased by 6 per cent in five years.<sup>31</sup> The Indian coffee market was much more attractive than the tea market due to lower levels of saturation and "continued industry dynamism."<sup>32</sup>

Coffee retailing was one of the fastest growing organized retail segments in India and had room for an additional 5,000 cafés. Illy CEO Andrea Illy saw potential in the Indian market: "I think specialty coffees in India are at the beginning. There is a good opportunity for growth particularly through espresso, which is totally consistent with the Indian taste because it is a high body, strong flavor taste, and mixes with local food and tradition."<sup>33</sup>

While the rest of the world dealt with an economic slowdown, India experienced unprecedented growth and was the second fastest growing economy in the world. As a result, the country boasted 300 to 350 million middle-income earners who had relatively high disposable incomes. India's franchise sector expanded as the economy did. Franchising grew at a rate of 30 per cent and was India's second fastest growing industry. As of 2009, over 70 international franchise operations operated in the country, while it became the "business model of choice" for the food and beverage industry.<sup>34</sup> Although India represented a lucrative market in terms of the rising middle class and interest in Western culture and way of life, the franchising sector was still young. The country's banking system and bureaucracy had the potential to

<sup>28</sup> Noerr LLP, "Franchise 2011: Germany,"

[www.nacsonline.com/NACS/News/FactSheets/MerchandiseandServices/Pages/Coffee.aspx](http://www.nacsonline.com/NACS/News/FactSheets/MerchandiseandServices/Pages/Coffee.aspx), accessed February 17, 2012.

<sup>29</sup> Y. Aparna, "Coffee Parlours in India – Hotting Up," 2003, IMCR Center for Management Research. Hyderabad, 2003.

<sup>30</sup> Shalini Hasan, "Costa Coffee in India," IBS Case Development Center, Hyderabad, 2006.

<sup>31</sup> Boby Kurian and Reeba Zachariah, "Starbucks Coffee Company Set for Café Joint Venture with Tatas," *Economic Times*, October 11, 2011,

[www.search.proquest.com.ezproxy.rollins.edu:2048/abicomplete/docview/896965090/1325AC9D3E66B29BB4/1?accountid=13584](http://www.search.proquest.com.ezproxy.rollins.edu:2048/abicomplete/docview/896965090/1325AC9D3E66B29BB4/1?accountid=13584), accessed February 14, 2012.

<sup>32</sup> Business Monitor International, "India: Food & Drink Report Q4," 2011,

<http://www.search.proquest.com.ezproxy.rollins.edu:2048/abicomplete/docview/893679875/1327917278F1BD5F09/3?accountid=13584>, accessed February 14, 2012.

<sup>33</sup> Eduardo Silva, "Can Starbucks Brew Instant Success in the Indian Market?"

[www.coffeeclubnetwork.com/redes/form/post?pub\\_id=2774](http://www.coffeeclubnetwork.com/redes/form/post?pub_id=2774), accessed February 17, 2012.

<sup>34</sup> Manjushree Phookan, "India: Legal and Regulatory Aspects of Doing Business in the Franchising Industry,"

[http://franchise.org/uploadedFiles/Franchise\\_Industry/International\\_Country\\_Profiles/India\\_Franchise%20Sector\\_July%202009.pdf](http://franchise.org/uploadedFiles/Franchise_Industry/International_Country_Profiles/India_Franchise%20Sector_July%202009.pdf), accessed February 17, 2012.

hinder business and successful partnerships. Dividing India into individual markets for expansion was strongly recommended.<sup>35</sup>

India's capital, New Delhi, was approximately 5,929 kilometers away from Rome, Italy. The flight time from New Delhi to Rome was approximately eight hours.

## JAPAN

Japan was the world's third largest coffee importer, over countries such as Italy and France.<sup>36</sup> Although the hot drinks sector in Japan was expected to have lower demand in 2011 and after, coffee sales were expected to grow at a compound annual average growth rate of 5.4 per cent to 2015, which outpaced the country's traditional drink, tea. "The outlook for the country's hot drinks sector is considerably brighter than that of the alcoholic drinks sector . . . this is due to a continued emphasis on product innovation by major producers and continued strong consumer interest, particularly from older consumers."<sup>37</sup> Innovation, in terms of products and packaging, and convenience were key to growth. "Modern coffee shops will continue to influence customers' preferences, although ready-to-drink-coffee is also fast gaining popularity in Japan."<sup>38</sup>

While the popularity of coffee shops grew in Japan, the value consumers placed on convenience made "off-trade sales" a stronger potential growth channel. Starbucks expanded its number of store locations in Japan and worked with Suntory "to develop new products for retail distribution, such as its new take-home coffee brand Via." Additionally, there were opportunities in healthier and weight-conscious beverage alternatives. Another trend was taste innovation: "Manufacturers are striving to provide novelty in terms of health, mellow taste, and added-values, through the addition of traditional ingredients such as black bean and ginger."<sup>39</sup>

The franchising sector in Japan had flattened out, in part because of poor economic conditions. As a result, it was important for companies to adjust their concepts to local tastes and expectations in order to ensure success. Another important aspect of franchising in Japan was the identification of the right business partners.

Japan's capital, Tokyo, was approximately 6,138 kilometers away from Rome, Italy. The flight time from Tokyo to Rome was approximately 13 hours.

## UNITED KINGDOM

The coffee industry in the United Kingdom grew stronger. In 2010, U.K. coffee drinkers increased their visits to coffee shops. In fact, coffee shops were a £5 billion industry.<sup>40</sup> Growth of branded coffee outlets

<sup>35</sup> Bachir Mihoubi, "Dealing with the Complexities of International Expansion," [www.franchise.org/Franchise-Industry-News-Detail.aspx?id=53325](http://www.franchise.org/Franchise-Industry-News-Detail.aspx?id=53325), accessed February 17, 2012.

<sup>36</sup> Oliver Strand, "Coffee," *The New York Times*, November 30, 2009, <http://topics.nytimes.com/top/reference/timestopics/subjects/c/coffee/index.html?scp=4&sq=starbucks&st=cse>, accessed February 12, 2012.

<sup>37</sup> Business Monitor International, "Japan: Food & Drink Report Q3 2011," [http://search.proquest.com.ezproxy.rollins.edu:2048/abicomplete/docview/876624562/13516DD8B0B3F5C00F2/11?account\\_id=13584](http://search.proquest.com.ezproxy.rollins.edu:2048/abicomplete/docview/876624562/13516DD8B0B3F5C00F2/11?account_id=13584), accessed February 17, 2012.

<sup>38</sup> *Ibid.*

<sup>39</sup> *Ibid.*

<sup>40</sup> Caterer and Hotelkeeper, "Coffee Drinkers Defy the Downturn," <http://search.proquest.com.ezproxy.rollins.edu:2048/abicomplete/docview/873820700/fulltextPDF/1322CDAEB4B599015C7/12?accountid=13584>, accessed February 24, 2012.

remained stable at 6.1 per cent in 2010. Managing director Jeffrey Young of Allegra Strategies was optimistic about market growth as well: “I have never seen such exciting developments in the UK coffee shop market. This year the market grew by more than 12% compared with 2.5% for the UK retail sector, adding more than 800 outlets in 2010 in challenging economic times. The market is poised for significant further growth over the next 3–5 years.”<sup>41</sup> Even the credit crunch of 2008–09 did not stymie coffee shop growth in the United Kingdom; from October 2008 to October 2009, 164 new coffee shops opened, which represented an increase of 60 per cent. This was attributed to the ability of companies to secure premium locations at lower prices.<sup>42</sup> “Nearly every street has been impacted and the coffee sector defies all the recessionary gloom that has been seen elsewhere. Caffeine really has been the most significant stimulus to the UK high street in this recession.” Independent coffee shops represented another important part of the U.K.’s coffee industry, accounting for 71 per cent of outlets.<sup>43</sup>

Historically a tea-drinking nation, coffee has taken up permanent residence in the United Kingdom. A study by Glasgow University found that “the young and old, homeless and upper class, taste conscious and tasteless have all taken coffee shops to their hearts and created a new kind of socializing.”<sup>44</sup>

There were 842 franchise systems in the United Kingdom, represented by 34,800 franchise units. There were few restrictions to franchising, which made it one of the easiest places in Europe in which to set up and run a business. The UK Trade and Investment Agency helped foreign businesses invest and locate in the United Kingdom, and there were no restrictions on foreign as compared to domestic franchisors.<sup>45</sup>

The United Kingdom’s capital, London, was approximately 893 kilometers away from Rome, Italy. The flight time from London to Rome was approximately two hours.

## UNITED STATES

Statistically, the United States was the global leader for coffee; it consumed about 25 per cent of the world’s market.<sup>46</sup> Over 50 per cent of Americans 18 and over consumed coffee every day. A 2009 study of the coffee shop industry in the United States revealed that although there were 20,000 stores with annual revenues of about \$11 billion, the top 50 companies held over 70 per cent of industry sales.<sup>47</sup> The U.S. coffee market was characterized by high consumption, high saturation and concentration, a diverse demography and premium coffee as an affordable luxury good. Young adults drank more coffee, while the specialty coffee market was growing. Between 2000 and 2005, the specialty coffee market grew over 40 per cent, while improved roasting methods, better brewing equipment and higher grade coffee beans improved quality and raised customer expectations.<sup>48</sup> Coffee was a cultural obsession in the United States;

<sup>41</sup> *Ibid.*

<sup>42</sup> Patrick Clift, “Caffeine Stimulates High Street as More Cafes Open,” <http://search.proquest.com.ezproxy.rollins.edu:2048/abicomplete/docview/223771840/fulltextPDF/1322CDAEB4B599015C7/20?accountid=13584>, accessed February 24, 2012.

<sup>43</sup> *Ibid.*

<sup>44</sup> Miki Moore and Ken Moore, “Coffee Culture in the UK,” <http://cafecrem.wordpress.com/2008/11/09/coffee-culture-in-the-uk/>, accessed February 17, 2012.

<sup>45</sup> Hamilton Pratt, “Franchise 2011: United Kingdom,” [www.franchise.org/uploadedFiles/Franchise\\_Industry/International\\_Development/United%20Kingdom.pdf](http://www.franchise.org/uploadedFiles/Franchise_Industry/International_Development/United%20Kingdom.pdf), accessed February 17, 2012.

<sup>46</sup> Strand, “Coffee.”

<sup>47</sup> Nina Samaldi, “IBISWorld Industry Report 72221b: Coffee & Snack Shops in the US,” <http://clients.ibisworld.com.ezproxy.rollins.edu:2048/industryus/default.aspx?indid=1973> accessed May 14, 2012.

<sup>48</sup> First Research, “Industry Profile: Coffee Shops,” [http://search.proquest.com.ezproxy.rollins.edu:2048/abicomplete.docview/192463238/fulltextPDF/1321075EF8488208B4/11?accountid=1131](http://search.proquest.com.ezproxy.rollins.edu:2048/abicomplete/docview/192463238/fulltextPDF/1321075EF8488208B4/11?accountid=1131), accessed February 17, 2012.

almost 20 per cent of adults drank gourmet coffee daily. The “third place” atmosphere of coffee shops had become a place for students, businesspeople and friends. The Starbucks phenomenon created high demand for specialty coffee. Coffee was enjoyed in coffee shops as well as on the go, and there were thousands of chain and independent coffee shops around the country. “The typical customer for a coffee shop is 25–45, affluent and educated. Specialty coffee appeals to a diverse adult demographic, including college students and young adults.”<sup>49</sup>

The U.S. coffee industry was strengthened by the growing perception of the health benefits of coffee drinking, as well as increased popularity and demand for specialty coffee. Despite the relatively concentrated and saturated nature of the U.S. coffee franchising market, there were still opportunities for development. For example, although there were many coffee shops, the number of coffee shops per person in the United States was far lower than that of Italy. Customers in the United States looked for a number of different attributes in their coffee experience including a unique retail experience, access to wi-fi, product innovation and health trends.

The capital of the United States, Washington, DC, was approximately 4,497 kilometers away from Rome, Italy. The flight time from Washington, DC to Rome was approximately nine hours.

### **INTERNATIONALIZATION: WHAT SHOULD ESPRESSAMENTE DO NEXT?**

As part of the market selection process, Reale looked for key success factors in each market that would determine the best market selection (see Exhibits 4 and 5). The criteria included:

- Coffee consumption
- Coffee shop concentration
- Income per capita of the top 10 per cent of the population
- Urbanization rate
- GDP per capita
- Ease of Doing Business rank
- Most attractive segments
- Coffee sales.

While market selection was critical, mode of market entry was important as well (see Exhibit 6). Reale could pursue a number of different expansion strategies including direct franchising, master franchising, area franchising, sequential franchising, multi-unit franchising, joint venture and wholly owned subsidiary.

- Direct franchising: A franchisor provides materials, training and other forms of support to a franchisee, who pays a fee to license the company’s trademarks, products, and/or services. A well-functioning franchise provides a win-win arrangement for both parties: the franchisor gets to expand into new markets with little or no risk and investment while the franchisee gets a proven brand, marketing exposure, an established client base and management expertise to help it succeed.
- Area franchising: Area franchising allows a franchisee, or area developer, to enter into an agreement to develop a minimum number of outlets within a specified territory.<sup>50</sup>

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<sup>49</sup> *Ibid.*

<sup>50</sup> *Ibid.*

- Master franchising: Master franchising allows franchisees to extend sub-franchise rights within a specific territory.<sup>51</sup>
- Multi-unit franchising: Multi-unit franchising allows the franchisee to operate more than one unit, which are usually acquired at a reduced rate per unit. The franchisee would be involved in the day-to-day operations.<sup>52</sup>
- Sequential franchising: Sequential franchising occurs when a franchisee must prove capable of operating one franchise before being granted a second and capable of operating two franchises before being granted a third, etc.<sup>53</sup>
- Joint venture: A joint venture is created when two or more companies share ownership of a third commercial entity and collaborate in the production of its goods or services.<sup>54</sup>
- Wholly owned subsidiary: Establishing a wholly owned subsidiary involves buying an existing business or building new facilities in a target country. It is the most capital intensive mode of entry, and is typically viable for only large, internationally experienced corporations.<sup>55</sup>

The mode of entry also weighed heavily on which market Espressamente chose to enter first. In markets that were incredibly different from Italy's, it would be beneficial to pursue joint ventures or partnerships to help the company navigate local culture, trends and norms. This may not be as important in markets more similar to Italy's.

Reale also recognized the importance of timing. As companies looked to international markets for expansion, pace, rhythm and scope had to be considered in order to plan, strategize and organize the company for success; determining the appropriate levels of pace, rhythm and scope were necessary for Espressamente's expansion.

- Pace: "The rate of opening new stores abroad."
- Rhythm: "The regularity by which stores were opened abroad."
- Scope: "The number of new countries entered."<sup>56</sup>

"How do I prioritize these markets and determine the best mode of entry for each?" Reale thought to himself. There was so much information to consider. He looked out the window of his Trieste office, took a sip of perfect coffee and then turned his head back to his computer to contemplate the future expansion of Espressamente.

<sup>51</sup> Don Daszkowski, "Different Types of Franchise Ownership," <http://franchises.about.com/od/buyingafranchise/tp/different-types-of-franchise-o.htm>, accessed February 27, 2012.

<sup>52</sup> Ibid.

<sup>53</sup> Callum Floyd, "Different Types of Franchising," [www.franchise-chat.com/resources/franchise\\_forms.htm](http://www.franchise-chat.com/resources/franchise_forms.htm), accessed February 27, 2012.

<sup>54</sup> Ilan Alon, "Global Marketing: Contemporary Theory, Practice and Cases," McGraw Hill, New York, 2013, p. 212-218.

<sup>55</sup> Ilan Alon, "Global Marketing: Contemporary Theory, Practice and Cases," p. 220.

<sup>56</sup> Rob Alkema, Mario Koster and Christopher Williams, "Resuming Internationalization at Starbucks," Ivey Publishing, product #9B10M073, 2010.

Exhibit 1

ESPRESSAMENTE THROUGH PICTURES



Source: Company files.

## Exhibit 2

## COMPETITORS

	Country affiliation	Core competencies	Geographical dispersion	Main market of operation	Expansion/contraction in recent years
Starbucks	United States	People, real estate/location, roasting coffee, the Starbucks Experience.	At the close of fiscal 2010, there were 16,858 company stores, 11,131 of which were located in the United States.	United States	In 2008–09, Starbucks scaled back its international expansion and even closed stores in the United States, although it is currently expanding once again.
McDonald's	United States	Premium coffee at McDonald's prices, market strategy, internationalized infrastructure	International: McCafé's had their own store fronts in markets other than the United States.	United States	McDonald's realized its lackluster coffee offerings were harming its competitive edge and introduced premium coffee in 2006; today, McDonald's sales have outpaced many of its peers in the United States, a result credited to the McCafé beverage line.
Costa Coffee	United Kingdom	Flexibility, adaptability and localization in international markets, 40-year roasting heritage, marketing	25 countries worldwide, first coffee company to enter India; 30 countries by 2015.	United Kingdom (largest chain in the United Kingdom)	In January 2011, Costa reported 35 consecutive quarters of positive like-for-like growth.
Lavazza	Italy	Tradition of quality and innovation, acquisitions; Lavazza as a coffee company, not a coffee shop company.	Foreign subsidiaries and distribution in 80 countries.	Italy/international	Acquisition of companies/production facilities in India have allowed it to take advantage of new markets.
Tchibo	Germany	Diversification/product development, distribution system.	Market leader for roasted coffee in Germany, Austria, Poland, Czech Republic; exports to over 40 countries.	Germany	Diversified, exports to over 40 countries.
Segafredo	Italy	Acquisition of brands, supply chain.	70,000 clients worldwide; operations in Europe, North and South America, Asia and Australia with roasting plants in Italy, Austria, Brazil, Finland, France, Poland and the Netherlands.	Italy	Over 600 franchised locations around the world and growing.
The Coffee Bean and Tea Leaf	United States	Technology, incorporation	750 stores in 22 countries.	United States	The company franchised internationally, particularly in Asia.

Source: Ilan Alon. "The Internationalization of *Espressamente*," 2012.

## Exhibit 3

## ILLY COMPANY DATA

ILLY SALES VOLUME IN THOUSAND KG				
	2008	2009	2010	2011
<b>Brazil</b>	51	26	40	66
<b>Brazil KG growth</b>		-49%	53%	61%
<b>India</b>	9	14	30	15
<b>India KG growth</b>		49%	110%	50%
<b>Japan</b>	146	114	121	129
<b>Japan KG growth</b>		22%	6%	6%
<b>Germany</b>	450	469	530	863
<b>Germany KG growth</b>		4%	13%	63%
<b>North America</b>	1,75	1,442	1,523	1,634
<b>North America KG growth</b>		-8%	6%	7%
<b>United Kingdom</b>	721	756	782	830
<b>United Kingdom KG growth</b>		5%	3%	6%

ILLY SALES VOLUME IN EUROS						
	2008	2009	2010	2011		
<b>Brazil</b>	€ 523,372.95	€ 319,924.94	€ 576,205.30	€ 1,051,485.25		
<b>Brazil sales growth</b>		39%	81%	82%		
<b>India</b>	€ 94,480.00	€ 132,370.00	€ 323,876.15	€ 168,711.09		
<b>India sales growth</b>		40%	145%	48%		
<b>Japan</b>	€ 1,397,697.89	€ 1,096,321.50	€ 1,268,613.55	€ 1,516,945.58		
<b>Japan sales growth</b>		22%	16%	20%		
<b>Germany</b>	€ 10,354,085.00	€ 11,173,000.00	€ 12,510,871.64	€ 18,327,762.04		
<b>Germany sales growth</b>		8%	12%	46%		
<b>North America</b>	€ 35,550,976.00	€ 34,980,000.00	€ 39,334,977.80	€ 42,265,778.16		
<b>North American sales growth</b>		-2%	12%	7%		
<b>United Kingdom</b>	€ 7,322,767.49	€ 7,943,169.77	€ 8,389,957.61	€ 10,065,723.58		
<b>United Kingdom sales growth</b>		8%	6%	20%		

Source: Company files.

## Exhibit 3

## COUNTRY INFORMATION

		COUNTRY INFORMATION							
	Equation (if relevant)	Italy	Brazil	China	Germany	India	Japan	United Kingdom	United States
Total population		61,016,804	203,429,773	1,336,718,015	81,471,834	1,189,172,906	126,475,664	62,698,362	313,332,044
Ease of Doing Business rank	Out of 183 countries	87	126	91	19	132	20	7	4
GDP per capita US\$		\$ 30,100	\$ 11,600	\$ 8,400	\$ 37,900	\$ 3,700	\$ 34,300	\$ 35,900	\$ 48,100
Urbanization (per centage of population)		68%	87%	47%	74%	30%	67%	80%	82%
Income per capita of the top 10% of the population USD	PPP GDP**% consumption/10% of population	\$ 80,202	\$ 47,717	\$ 12,680	\$ 90,878	\$ 11,672	\$ 95,431	\$ 102,275	\$ 144,047
Coffee consumption per capita, per annum, kilograms		5.80	5.30	0.02	6.50	0.08	3.40	2.80	4.10
Coffee sales in US\$million (2011)†	***\$1,032	\$ 4,871	\$ 3,206	\$ 6,556	\$ 735	\$ 4,618	\$ 945	\$ 11,000	
Coffee sales in US\$ (2011) per capita	Coffee sales in US\$/population	\$ 16.91	\$ 23.94	\$ 2.40	\$ 80.47	\$ 0.62	\$ 36.51	\$ 15.07	\$ 35.12
Illy coffee sales in US\$million (2011)	Original data in Euros; converted to dollars (1 Euro = 1.3198)	\$ 1.38	N/A	\$ 24.18	\$ 0.22	\$ 2.00	\$ 13.29	\$ 55.78	
# coffee shops*		200,000	N/A	560	1400	1800	82,000	15,773	20,000
Coffee shop concentration per million people	# outlets/population * 1,000,000	3,277.8		0.4	17.18	1.5	648.3	251.6	63.9
# Starbucks		0	20	250	147	0	722	727	11,131
Starbucks per million people	# Starbucks/population	0	0.10	0.19	1.80	0	0.57	11.60	35.54
Projected percentage market growth (percentage change in coffee sales 2011-2015)**		N/A	36%	64%	2%	83%	6%	16%	4%

Source: \*Data year: Italy 2012 ([http://coffee-statistics.com/coffee\\_statistics\\_ebook.html](http://coffee-statistics.com/coffee_statistics_ebook.html)); Brazil unavailable; China 2009, coffee chains specifically (<http://www.intracen.org/WorkArea/DownloadAsset.aspx?id=37584>); Germany 2008 (<http://cyberpress.de/2008/04/coffee-shops-booming-in-germany/>); India 2012 (<http://search.proquest.com.ezproxy.rollins.edu:2048/abicomplete/docview/920010101/fulltext/134EC9DFF036503B9E2/12?accountid=135584>); Japan 2006 (<http://search.proquest.com.ezproxy.rollins.edu:2048/abicomplete/docview/873820700/fulltextPDF/134E8B1AFF616A60506/1?accountid=135584>); US 2007 (<http://www.grin.com/ebook/111348/coffee-shop-industry-a-strategic-analysis>). Accessed May 14, 2012.

\*\*Data from Business Monitor International, except for U.S. data; U.S. data from IBISWorld Industry Report 72221b Coffee & Snack Shops in the US, statistic given as growth of coffee and snack shops 2011-16. [www.businessmonitor.com/](http://www.businessmonitor.com/) accessed May 14, 2012.

†\*\*Data for Italy based on 2010 value of imported coffee, adjusted from Euros to US\$, <http://clients.ibisworld.com.ezproxy.rollins.edu:2048/industryus/default.aspx?indid=1973> accessed May 14, 2012.

Variable sources: CIA World Factbook: Total population, GDP per capita US\$, Urbanization, Income per capita of the top 10% of the population; Doing Business: Ease of Doing Business rank; International Trade Center: Coffee consumption per capita, per annum, kilograms; Business Monitor International: Coffee sales in US\$million (2011), Projected percentage market growth; Illy Company Data: Illy coffee sales in US\$million (2011).

Exhibit 4

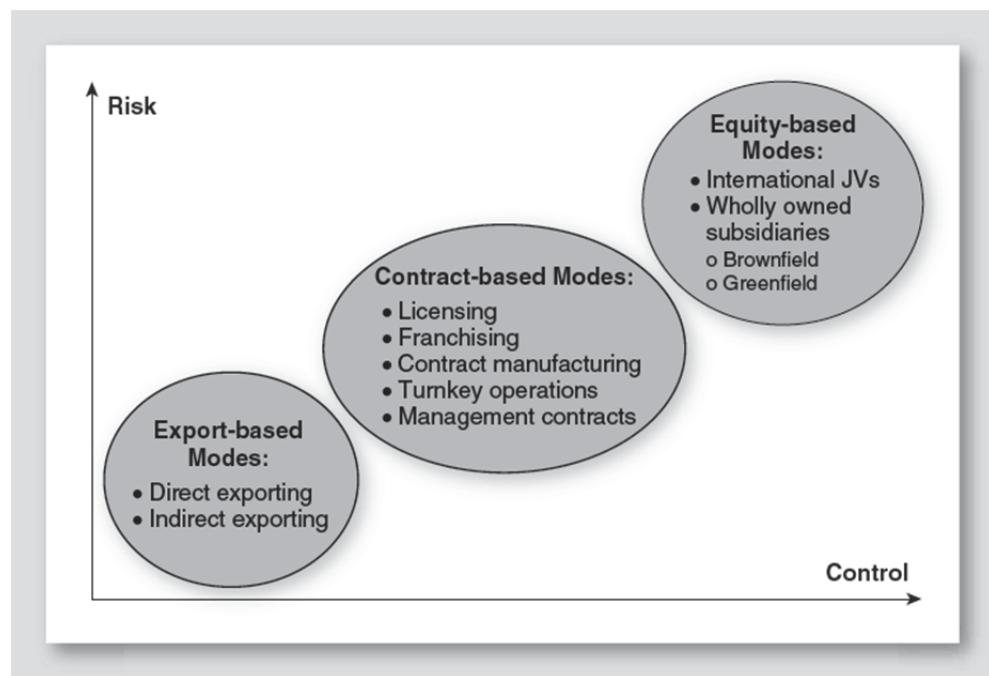
## HOFSTEDE'S DIMENSIONS

	Italy	Brazil	China	Germany	India	Japan	United Kingdom	United States
<b>Power distance</b>	50	69	80	35	77	54	35	40
<b>Individualism</b>	76	38	20	67	48	46	89	91
<b>Masculinity</b>	70	49	66	66	56	95	66	62
<b>Uncertainty avoidance</b>	75	76	40	65	40	92	35	46
<b>Long-term orientation</b>	34	65	118	31	61	80	25	29

Source: <http://geert-hofstede.com/countries.html>, accessed May 14, 2012.

Exhibit 5

## RISK AND CONTROL CONSIDERATIONS IN SELECTING AN ENTRY MODE



Source: Ilan Alon, "Global Marketing: Contemporary Theory, Practice and Case," McGraw Hill, New York, 2013, p. 206.

## Exhibit 6

## ILLY COMPANY DATA

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Source: Company files.