

REINVENTING INNOVATION AT NESTLÉ¹

"I have worked for Nestlé for 22 years, and I have never seen such rapid changes in the market, consumers, and products as in the last few. We need to innovate faster."

Stefan Palzer

Chief Technology Officer & Executive Vice President

Member of the Global Executive Board, Nestlé S.A.

With sales of 94.4 billion CHF in 2022, a consolidated presence in 188 countries, and 275.000 employees, Nestlé was the biggest food company in the world by far. Thanks to its ability to generate value both for shareholders and society, it was also the most profitable, with shareholders enjoying a remarkable record of a 28th consecutive annual dividend increase in 2023. Founded in 1866 and constantly evolving, the company defined itself as a nutrition, health, and wellness company. Exhibits 1 and 2 include additional basic information about Nestlé².

Nestlé boasts the most advanced science and innovation network in the food industry, investing 1.7bn CHF annually in R&D as a growth engine. Its 4.100 employees in the R&D teams, who work across 23 locations worldwide, include scientists, engineers, nutritionists, and regulatory specialists and are key to Nestlé's success in driving sales growth through scientific research and rapid innovation.

At the helm of Nestlé's R&D efforts was Stefan Palzer, who was appointed to the position in January 2018 (for more details on his professional career, see Annex 1 at the end of this document). The new Chief Technology Officer (CTO) was appointed by an also recently appointed CEO, Mark Schneider, who began his tenure in January 2017. Before stepping up into this position, Mark Schneider was the CEO of Fresenius³, a multinational giant in the health industry. His appointment as CEO came as a surprise to

¹ Case of the Research Division of San Telmo Business School, Spain. Prepared by professors Manuel González-Toruño and Antonio Garcia de Castro with the assistance of Mr. Vincenzo Marino of San Telmo Business School, for use in class, and not as an illustration of the proper or improper management of a given situation. Copyright © february 2024. Fundación San Telmo, Spain.

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² All figures in this case are expressed in CFH (Swiss francs). In T1 2023, the €/CHF exchange rate was almost 1/1. The average whole year in 2022 was 1,0000€= 1,0051 CFH.

³ <https://www.fresenius.com/>

many, as Schneider was the first CEO from outside the company since 1922. However, Peter Brabeck, Nestlé's Chairman at the time, explained that *"the appointment of Mark Schneider underscores the company's ambition to become the world's leading player in the nutrition, health, and wellness sector."*

Palzer and his team began to work on making R&D more relevant, effective, and efficient. However, taking into consideration some external factors, he realized that even achieving these goals would not be enough. It was also necessary to **accelerate innovation at a much faster pace.**

THE ENVIRONMENT OUTSIDE NESTLÉ

The food & beverage industry had undergone many rapid changes in recent years. While different players may have varying opinions on which trends are most relevant and impactful, we will describe Nestlé's view, which highlights four key trends:

1.- Food and nutrition are exciting topics for many.

For some individuals, food has even become a new religion, with many interested in the philosophy behind nutrition. People now take a stance and define themselves by what they "don't eat," which is a relatively new phenomenon. This process has been amplified by social media and food bloggers, for example. As a result, consumers have become much more open to innovation in food.

Ten years ago, the situation would have been entirely different, as people were much more conservative when it came to food innovation. The market has since become highly fragmented, with individuals and groups emphasizing different attributes: some look for natural products, while others seek something original, genuine and authentic, good for the planet, for Earth and animals..... We can refer to this as the "time of food ideologies." This has dramatically changed demand, especially in some regions such as Central Europe and the USA.

2.- The start-ups' ecosystem.

The start-up ecosystem is disrupting the traditional food industry with plant-based alternatives such as meatless chicken strips, vegan beverages, and plant-based hamburgers that contain all the necessary ingredients for human sustenance and make it optional to bother eating ordinary food ever again. As The Economist⁴ pointed out in an article dated back in 2015, the idea of making such products is attracting entrepreneurs and venture-capital firms who think that the traditional food industry is ripe for disruption as it is inefficient, inhumane, and in need of an overhaul. Albeit with different approaches, these start-ups share an aim to create new plant-based food that they claim to be healthier, cheaper, and just as satisfying as animal-based products but with a much lower environmental impact.

⁴ <https://www.economist.com/technology-quarterly/2015/03/05/silicon-valley-gets-a-taste-for-food>.

Start-ups are not targeting only the small percentage of the population who follow a plant-based diet but also those who love meat and dairy products but wish to reduce their consumption. That means replicating the meaty, cheesy, or creamy flavors and textures that many people crave.

Plant-based food is just one of many food issues that start-ups are working on. Consumers, retailers, and legislators are pressuring the food industry to produce food in a more efficient, healthy, and sustainable way. These challenges include reducing food waste and sugar consumption, zero chemical residues, working on food safety and traceability, and many more. Private equity has supported start-ups working to overcome these challenges.

According to Stefan Palzer, in an interview conducted by the authors in December 2022:

“Start-ups can operate differently from the big multinational companies because they have little to lose. They create their value proposition, and if the product they bring to the market does not meet the demand, that’s often not a drama; they simply move on without suffering from brand equity losses. Furthermore, start-ups have raised a lot of money in the capital markets to try new things, inevitably putting pressure on the food industry. Therefore, big companies like Nestlé must adapt to this new environment if we want to survive.

Have we seen a loss of market share? Well, let’s just say incumbent companies have been losing relevance because the younger generation is finding other more relevant and appealing products. As a result, we at Nestlé had to make significant changes to how we innovate by shifting from renovation to true innovation. However, to achieve effective innovation, we must be relevant, which requires both effectiveness and also efficiency. Effectiveness involves creating a higher level of differentiation, while efficiency means achieving this quickly and at a relatively low cost”.

3.- Sustainability.

Consumers have been displaying a growing interest in natural and sustainable products, with local sourcing and sustainable packaging becoming increasingly important factors in their purchasing decisions. This trend has been observed in many countries worldwide. More importantly, there has been a ripple effect: food retailers have taken notice of these customer concerns and have been pressuring food industry suppliers to include these criteria in their products. In some cases, retailers have even stopped buying from suppliers who do not meet these standards. However, this does not mean that consumers are sacrificing other attributes in favor of sustainability. Rather, sustainability has become an additional consideration.

According to the United Nations, livestock uses around 30% of the world’s ice-free landmass and is responsible for producing 14.5% of all greenhouse-gas emissions. Moreover, meat production requires vast amounts of water and feed for animals; for instance, producing 1kg of live animal weight in the United States typically requires 10