**Competitive Strategy:**

Cola Wars Continue: Coke and Pepsi in the Twenty-First Century

**JRL Consulting**
**Cross-Cultural Technology Management**
E-Mail : tech@jrleeconsulting.com
Website : www.jrleeconsulting.com

# Table of Content:

Introduction

The Soft Drink Industry

Porter’s Five Forces Model

The Strategy and sustainability

Introduction:

This case examines the competitive strategies deployed by Coca-cola and Pepsi since their establishment in early 1890's. Pepsi was a small player and a number 3 in the market behind Coca-cola and Dr. Pepper in 1940s. The fierce Cola Wars between Coca-cola and Pepsi began in the year of 1950 when Pepsi promoted a former Coca-cola executive, Alfred Steele, to its CEO position. For the next 50 years, Coca-cola and Pepsi had fiercely competed for the "throat share" of the world's soft drink market. The main battle field was in the US because the size of the market (60 Billions Dollars) and the big volume it consumed. American drank 874 eight-ounce cans of Carbonated Soft Drinks (CSDs) in 1999, by comparison Chinese drank 22 eight-ounce cans and Indonesian drank 9. With their unique Duopoly situation in the soft drink industry, both Coke and Pepsi managed to achieve average annual growth of around 10% from 1975 to 1995 in worldwide market. With the US consumption dropped in the recent years, both companies scrambled to find the best strategies to resolve this crisis. To address the issue concerning both companies about their eras of sustained growth and profitability and propose recommendations, we need to study the soft drink industrial structure. One key question will be addressed: "Why is the CSD industry so profitable?" using Porter's 5 force model. The same model will be used to analyze the similar strategies (1) bolstering domestic markets (2) diversify into non-carbonated drinks (3) cultivating international markets currently used by both companies to address their suitability in current crisis.

## The CSD (soft drink) Industry:

A typical CSD drink makes of carbonated water, a sweetener (sugar or high fructose corn syrup), and a specialty flavor. Four major participants involve in this value chain of producing and/or distribution of CSDs. These four participants are (1) Concentrate producers (CPs) (2) Bottlers (3) Retail channels and (4) Suppliers.

The roles of these participates will be outlined for their functions:

(1) Concentrate producers: The CPs blended raw material ingredients, packaged it in plastic canisters, and shipped the blended ingredients to the bottler. Coke and Pepsi are the two biggest CPs in the world. The most significant expense for CPs was the money spent on advertising, promotion, market research as well as bottlers' relation. Since the majority of the CSD is carbonated water, one ingredient plant of 25-50 million US dollar investment could supply the whole US CSD' needs.

(2) Bottlers: Bottlers purchased concentrate then added carbonated water and sugar (or high fructose corn syrup) to the CSD. These CSD were then bottled or canned based on the demand and delivered to customer accounts. For Coke and Pepsi, they provided "direct store door" (DSD) delivery to the store and manage the CSD in that store as a routine service to both bottlers and retail store. A four-line production bottler can produce 40 million case (24 eight-ounce) DSD. There are 80-85 plants needed to fully supply US CSD' needs.

(3) Retail Channels: In 2000, the distribution of CSDs took place in 5 different channel categories (a) Food stores (35%) (b) Fountain outlets (23%) (c) Vending machine (14%) (d) Convenience stores (9%) and (e) Other outlets (20%). Bottlers' profitability would

impact substantially based on delivery methods, frequency, volume, advertising and marketing.

(4) Suppliers to CPs and Bottlers: CPs need the supplies of caramel coloring, phosphoric and/or citric acid, natural flavors and caffeine. Bottlers need the supplies of packaging material of plastic bottles and metal cans as well as sweetener of sugar (or high fructose corn syrup) and artificial sweetener (predominantly aspartame). 60% of the CSDs were packaged in the can form. There are several "can manufacturers" included American National Can, Crown Cork & Seal and Reynolds Metals that could produce more than enough can for packaging. These major can manufacturer often completed for a single contract.

## Porter's Five Forces Model

Porter's Five Forces Model:

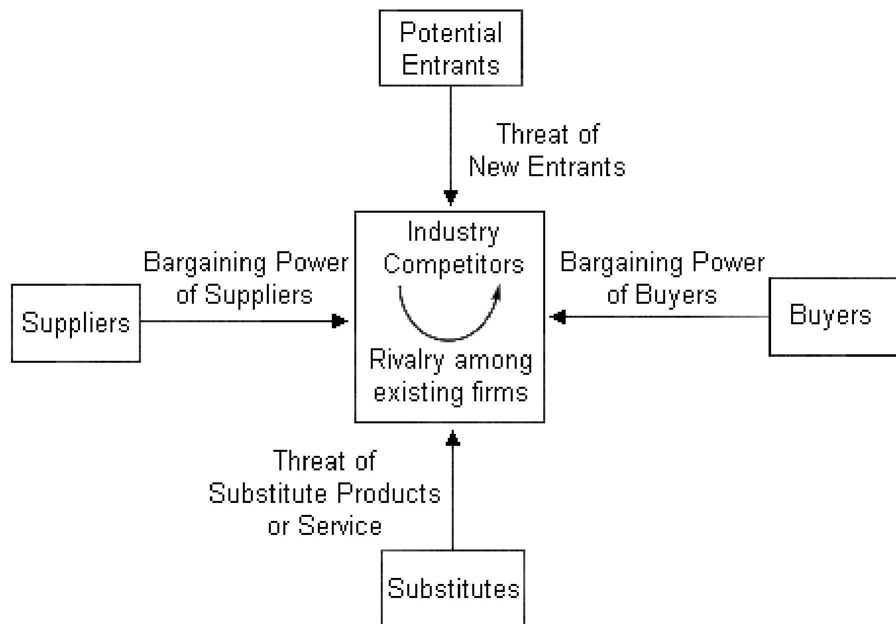

Figure 1 The block diagrams of Porter's Five Force Model

This model outlines the attributes of the CSDs industry by using five different categories: 1) Threat of entry by potential competitors, 2) Bargaining power of buyers, 3) Bargaining power of suppliers, 4) Threats of substitutes to an industry's products and 5) the intensity of rivalry among established companies within an industry. By analyzing these contending forces, and we will be able to address the strategy deployed (or should be formed) can redeem the best profitability for the companies (Coke and Pepsi).

1) Potential entrants

The barriers to entry into CSD business are high. (a) Economies of scale, Coke and Pepsi combined with 90% of CSD markets (b) Product differentiation, Coke and Pepsi combined with 23 different flavored CSD (c) Capital requirements, It will take 75-80 million to build a bottlers (d) Access to distribution channels, with existing distribution channels locked by three CPs (Coke, Pepsi and Schweppes), there will be very difficult to access a broad distribution channels. (e) Government policy, Coke and Pepsi were Duopoly, not Monopoly, there was not problem for anti-trust issue.

2) Bargaining power of buyers

**Exhibit 7** U.S. CSD Retail Outlets, 2000

| | Food Stores | Convenience Stores | Fountain | Vending | Other | Total |
|---|---|---|---|---|---|---|
| Percent of industry volume | 34.8% | 8.5% | 23.1% | 13.5% | 20.1% | 100.0% |
| **Share of channel:** | | | | | | |
| Coca-Cola (all brands) | 36.1% | 35.7% | 65.0% | 50.0% | 35.5% | 44.1% |
| Pepsi-Cola (all brands) | 32.2% | 41.5% | 21.0% | 40.0% | 33.3% | 31.4% |
| Other brands | 31.7% | 22.9% | 14.0% | 10.0% | 31.2% | 24.5% |
| **Bottling Profitability Per Case:**[a] | | | | | | |
| Net Price | $3.53 | $5.35 | $3.18[b] | $8.48 | $3.42 | $4.24 |
| NOPBT[b] | $0.23 | $0.69 | $0.09[b] | $0.97 | $0.33 | $0.36 |

Source: Industry analysts and casewriter estimates.

[a]One case is equivalent to 192 oz.

[b]Net Operating Profit Before Tax.

[c]Industry average, excluding Coca-Cola bottlers. The Coca-Cola Company supplies fountain outlets directly.

From the exhibit 7, we learned that the fountain segment are the most powerful buyers, that both Pepsi and Coke earning on this was (NOPBT) of $0.09. They consider this segment "paid sampling" sectors. The bargaining power of buyer is high for fountain, as well as supermarkets and mass merchandising for their big volume purchases. The bargaining power is much less for vending segment for its high profitability.

3) The Bargaining power of Suppliers: The bargaining power of supplier is low. Two major supplies needed for CSD were sugar (corn syrup) and metal can. These two are inexpensive and abundant. Coke and Pepsi could play the high power buyer to negotiate a good price for themselves as well as bottlers.

4) Existence of substitute products: There are great many substitute products to the CSDs, teas, coffee, juice, beers, wine, bottled water, milk, sport drink. The popularity of bottled

water, juice, milk due to health concern and their advertising provided a threat to consumption of CSDs.

5) Rivalry among Established Companies:

After the market consolidation, there are only two companies can complete head-to-head, but from 1975 to 1995, they had maintained a 10% growth for both companies. Coke and Pepsi were a mutual beneficiary competitors in a legal way. With their rivalry, a Duopoly market in CSD was formed.

By comparing with these 5 forces, the barriers were high, the buyer's power based their channels (could be high or low), the suppliers' bargaining power were low, the substitutes are great many, and the rivalry between Coke and Pepsi were healthy (mutual advantage). Both Coke and Pepsi were in a good position to benefit from this CSD industry.

## The Strategy and sustainability

Both companies would follow through their revised strategies on (1) bolstering domestic markets (2) diversify into non-carbonated drinks (3) cultivating international markets

(1) Bolstering domestic markets:

With the porter's 5 force model analysis, we had concluded both company can stay in this CSD business and sustain enough profit to survive, the advertisement, promotion as well as price cutting will follow. They should be able to maintain their market shares and potentially grab market shares from the number 3 Schweppes. The consumers' taste might change back to cola as it had been swing several times before.

(2) Diversify into non-carbonated drinks

From analyzing the existence of substitute products for CSDs, we discovered that there are great many substitute products to the CSDs, teas, coffee, juice, beers, wine, bottled water, milk, sport drink. The popularity of bottled water, juice, milk due to health concern and their advertising provided a threat to consumption of CSDs. With Coke and Pepsi's marketing research, they detected the trends and reacted to this trend. Both companies had expanded their brand portfolios to include these alternative beverages. For non-carbs drinks, Coke bought Dasani (bottled water in 1999), Pepsi purchased Aquafina in 1998. Coke also bought Minimaid (orange juice) while Pepsi purchased Tropicana in 1998, Gatorade in 2000 and Sobe in 2000. Both companies believed they could grab these beverages' market shares along with CSD.

(3) Cultivating international markets

In 1999, average American drank 874 eight-ounce cans of Carbonated Soft Drinks (CSDs), by comparison Chinese drank 22 eight-ounce cans and Indonesian drank 9. Globalization provides both companies with big opportunities and challenges. The Porter's 5 force model can also applies in this international markets for both Pepsi and Coke. Rivalry: Coke is the number brand in the world, and Pepsi finally decided to prevent direct competition with Coke. International sale counted for 62% of Coke total sale, but only 9% for Pepsi. Barriers to Entry: This might be problem for both companies because of the regulatory ruling, cultural issues as well as tax concerns. Suppliers' power is low since raw materials are commodities. Substitutes: These issues can be overcome by using Coke or Pepsi's brand extension power to their branding advantage.

These strategies are still valid and the profitability based on these strategies for both companies were sustainable.