

# Coke and pepsi war case study analysis



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Coke and Pepsi, two of the largest carbonated soft drink companies in the world, continue to battle within their \$75 billion industry. Although this has been a rivalry since day one, much of their success can be attributed to their counterpart. Without Coke, Pepsi wouldn't be the company it is today and without Pepsi, Coke wouldn't be a dominating force within the CSD industry. The competition they have between one another allows for new ideas and innovations to become implemented on a regular basis. Each company plays off the others successes and refrains from their failures. Like the Tom & Jerry of the CSD industry, Coke and Pepsi wouldn't be the profitable companies they are today without each other.

#### Carbonated Soft Drink Industry Analysis:

1. [Threats of Substitutes] –The threat of substitutes for this industry is very high. Consumers have an abundance of choices when it comes to beverages. Every day they choose between beer, milk, coffee, bottled water, juices, tea, energy drinks, wine, sports drinks, distilled spirits and tap water. It also costs very little to switch between products. Customers only incur switching costs, in most cases, that are the difference of cents. Brand loyalty is, however, a very strong competitive pressure within the industry. Customers are likely to claim allegiance and unlikely to switch between opposing companies.
2. [Threats of New Entrants] –The threat of new entrants is low within the CSD industry. Start-up costs to build a concentrate manufacturing plant and bottling process is extremely high. Concentrate plants are usually between \$50 to \$100 million while a fully functioning bottling service could reach hundreds of millions of dollars. New comers to the

industry would encounter a great deal of difficulty setting up proper distribution channels. Because the CSD industry has extreme competition for shelf space, the top brands hold contracts with the main supermarkets, gas stations and restaurants. Other costs are encountered when obtaining FDA and international production licenses. Similar to IKEA's beginning struggles, the CSD industry is an oligopoly and bigger companies have the power and tools to block or force out new entrants.

3. [Bargaining Power of Suppliers] –Suppliers hold low bargaining power because firms can switch between suppliers very easily, and for little to no cost. Becoming a supplier is also fairly easy within the CSD industry which means there is more competition between suppliers to lower costs. Suppliers of the industry include bottling equipment manufacturers, secondary packaging and raw material suppliers.
4. [Bargaining Power of Buyers] –Buyers also have low bargaining power. Coke and Pepsi controlled 72% of the U. S. soft drink sales in 2009. During the same time, the average American was consuming about 46 gallons of soda per year. However, with the average soft drink costing under \$2, individual purchases are relatively insignificant. The major buyers in the CSD industry are bottlers and fast-food restaurants who buy the concentrate straight from the manufacturers. This is where Coke and Pepsi make the majority of their revenue. Each company has a Master Bottler Contract. These bottlers entered into franchising agreements which allowed concentrate producers the rights to determine concentrate price. They also had no legal obligation to assist

bottlers with advertising or marketing. This considerably weakening bargaining power, and over the past two decades concentrate producers have regularly raised prices by more than the increase in inflation. In addition, concentrate producers granted exclusive territories to their bottlers, causing them to have no alternative suppliers. Fast-food restaurants, on the other hand, lost bargaining power due to acquisitions. Pepsi acquired Pizza Hut, Taco Bell and KFC while Coke retained exclusive pouring rights with Burger King and McDonalds.

5. [Intensity of Rivalry] –The intensity of rivalry is made up of two main players, Coke and Pepsi control 72% of the market. The few other smaller competitors consist of Dr. Pepper, Snapple Group and Cott Corporation. Growth rate of the CSD industry is not rapid making it difficult for smaller competitors to thrive. Brand loyalty and recognition is everything, and these companies have huge advertising budgets. Coke made enormous investments even to support its bottling network, contributing \$540 million in marketing support payments to its top bottler. Each company spends a large portion of their time on analyzing and tracking consumption habits, market trends and consumer purchasing patterns. For concentrate producers, exit barriers are relatively low, however, advertisements and contractual agreements with bottling companies make it more difficult to escape the industry. For bottlers, exit barriers are high due to the cost of machines.

The CSD Industry has historically been so profitable because threat of new entrants is low. Start-up costs are hundreds of millions of dollars. Federal regulations and licensing restrict new players, and distribution channels are difficult to establish. Bargaining power of suppliers are low because there are plenty of them making switching between them easy and cheap. Bargaining power of buyers is also low due to franchising agreements, territory barriers and pouring rights. Intensity of rivalry is also low even though it's very competitive between the top players. The only downfall to this industry is the threat of substitutes which has illuminated the importance of health and fitness. The growth of this industry has been stagnant because of these new trends. However, advertising campaigns and brand loyalty have caused the main players to thrive.

#### CDS Business vs. Bottling Business:

Concentrate manufacturers blend raw ingredients, package the mixture in plastic wrapping, and ship the concentrate to the bottler and fast-food chains. This production process involves relatively little capital investment in machinery, overhead and labor. A manufacturing plant capable of supplying the U. S could cost anywhere between \$50 million to \$100 million to build. A concentrate producer's most significant costs are advertising, promotion, market research and bottler support. Concentrate producers also set the price of their concentrate, often raising prices by more than the increase in inflation. They also set geographical territories for their bottlers causing the bottler to only have access to one supplier of concentrate. By negotiating directly with their suppliers, concentrate producers have been able to achieve a reliable supply, fast delivery, and low prices. If a problem should

arise with their current suppliers, concentrate producers can switch quickly, easily and cheaply. Once a business that featured hundreds of local manufactures has boiled down to only a few top and profitable players.

Bottlers purchase concentrate, add carbonated water and high-fructose corn syrup, bottle or can the resulting product, and deliver it to customer accounts. This process involves much higher capital investment in all three of the previous categories. Bottling and canning machines alone can cost \$4 million to \$10 million each. The cost of setting up an entire plant would accumulate to hundreds of millions of dollars. One thing you'll never see is a Walmart or supermarket employee stocking the shelves with Coke or Pepsi products. Bottlers are responsible for labor costs consisting of securing shelf space, stacking product, positioning labels, and setting up point-of-purchase displays. Master Bottling Contracts allowed for concentrate producers to set the price for their concentrate, weakening bottlers bargaining power.

Geographical territories were also assigned to bottling companies allowing little access to multiple suppliers, and decreasing bargaining power.

Franchising agreements also restricted bottlers from handling directly competing brands. Operating margins of bottlers were around 8% while concentrate producers were operating at 24% margins. Because of these factors, bottling companies went from more than 2000 in 1970 to just 300 in 2009.

Profitability of these two industries are so different because of the differences in capital investment in machinery, overhead and labor.

Concentrate producers are cost effective, have fewer restrictions, produce higher margins, and have an immense amount of bargaining power. Bottlers

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have high costs in machinery, overhead and labor; they are in terrible contract agreements with high restrictions, produce low operating margins, and have very little bargaining power.

#### Coke & Pepsi Sustainability:

Both Coke and Pepsi need to rebrand themselves. The health & fitness era is not over. People are consumer fewer sugared products and are really watching what is being put into their bodies. I believe profits will only continue to decline unless a change is made. International focus may be a serious play for their original product lines. Appealing to our millennial generation and the generations below us is going to take a considerable amount of research. Focus should be put on ways to produce fresh water. With only 3% of fresh water covering the earth, it would be interesting to produce more efficient ways of turning ocean water into safe drinkable products. PepsiCo made a good play in acquiring Gatorade, however, most athlete's I know don't drink it because the amount of sugar is so high. Pedialyte is becoming the new sports drink of choice. It also recently started a marketing campaign targeting hungover adults. Sugars and artificial sweeteners are out, health & fitness, and hydration products are in. It's time both Pepsi and Coke focused on rebranding towards this huge shift in market trend.