

Cola wars: coke and pepsi 2010 case study examples

[Business](#), [Company](#)



1. Why is the soft drink industry so profitable?

Soft drink industry is very profitable mainly because this industry is duopolized by two major soft drinks giants PepsiCo and Coke. Over last 4-5 decades they have enjoyed more than 70% market share by volume. Their duopolization in the market and their consolidation with the bottling companies has made the entry of new competitors almost impossible in the market. The factors that are impeding the entry of new competitors into the soft drink market are as follows:

- Bottling Network

Both PepsiCo and Coke have entered into a franchisee agreement with their bottle suppliers and these agreements prevent the bottlers from supplying to directly competing new brands. Further, a good many bottling companies have merged together into a big bottling consortium and both PepsiCo and Coke are purchasing a hefty percent of the bottling companies, thereby making it difficult for a new brand to find a bottler interested in doing business with them.

- Cost of Advertising and Marketing

Further the cost of advertising and marketing is huge for any new entrant to compete with the already established soft drink giants like Coke and Pepsi which spend billions in advertising and marketing their products. For instance, in each year starting from 2009, Coke has spent about \$3 billion on advertising and Pepsi about \$2 billion in promotional marketing of its beverage.

- Brand Image and Customers Base

PepsiCo and Coke with their years of advertising and promotional marketing

campaigns have set up a brand image and a loyal customer base which is not easy for a new entrant to break through.

- Retailer Shelf Space

Further the retailers get a considerable margin of 15-20% for providing shelf space to these two soft drink giants. These margins earn the retailers a good profit and therefore it will be harder for a new competitor to persuade retailers to give them shelf space along with Coke and Pepsi.

- Price Wars

Venturing into a market monopolized by two big-ticket rivals may lead a retaliation of price wars that the new entrant might not sustain.

Being the pioneers in the industry, both PepsiCo and Coke have enjoyed certain advantages which have contributed to their long-lasting profitability.

First Mover advantage is a well-known management concept that gives the pioneers of an industry some advantage in terms of growth, market share and popularity. There are many successful companies which have taken full advantage of being the first mover in an industry like Sony in stereo business, Gillette in safety razors. Despite the advantages, the long term success depends on how the first movers control and adapt to the market. Over the decades of their operation in the market, both PepsiCo and Coke have created a brand name for themselves in the carbonated soft drinks industry. They have huge market share all over the world. Taking advantage of the big brand name and market share, they control their suppliers and bottlers to establish a business cartel ensuring that no new entrant forays into the competing space of soft drinks.

In last few decades many product emerged in the market as substitutes for

coke and Pepsi, especially during the 1980s few new companies came up with bottled water and bottled readymade teas. Pepsi and Coke quickly responded to the threat with their own brands of bottled water, Aquafina and Kinley and other product innovations like Nestea, Orange Slice, and Minute Made. This expansion of their product offering ensured to have the emerging competition out of the market. This diversification caused some problem to the bottlers as they had to change the setup frequently. However, Coke did a backward consolidation with its bottlers to create more economies of scale which reduced the number of setup changes and the cost associated with it. The margin for the product got affected for few years but was restored to its original level after the consolidation.

The major suppliers for Coke and Pepsi are sugar producing companies and packaging companies. Sugar is a product available easily through many channels and hence sugar suppliers don't have much bargaining power over Coke and Pepsi. In packaging too aluminum can suppliers don't have bargaining power as there are lots of options. To make matters favorable for the bottlers Coke and Pepsi bargained with the suppliers on behalf of their bottlers. The same thing also is true for the plastic bottle manufacturers. The principle buyers of the soft drinks are food stores, fountains, vending machines, convenience stores and mass merchandisers. Supermarkets are the primary buyers of the products of Coke and Pepsi but the customers are not willing to pay more for the products which makes the business through this channel less profitable. Among other channels fountains are least profitable and the volume is also not great but Pepsi and Coke still continues to sell through this channel just to make its products more visible to the

mass. Vending machines are the most profitable channel as through this channel Pepsi and Coke can directly sell their products to the customers. Convenience stores also have some significant volume but they don't have the bargaining power like some of the national mass merchandisers and hence Pepsi and Coke make good amount of profit through these channels as well.

PepsiCo and Coke are competing with each other for more market share for a long time. These two companies put together controls almost 73% of the market share, thereby creating a duopoly in the market of carbonated soft drinks. Price wars took place between these two giants in 1980s and that eroded the profitability margins for both the companies significantly. Subsequently in 1990s and 2000s Pepsi continued to challenge Coke products by using different marketing strategies and positioning of its product but both the players have since then stopped pricing war. Thus the profitability of the companies has almost remained same over last 20 years.

2. Compare the economics of the concentrate business to the bottling business. Why is the profitability so different? Identify and describe the five forces of competition in the bottling industry.

Although the concentrate manufacturers and bottling business work hand in hand but the economics of the industry is totally different. The value of the industry comes from the patented formula which Coke or Pepsi have. They retain that patent very diligently and often go to significant length to protect it from any kind of infringement. Number of concentrate manufacturers is limited and the existing ones do everything in their power to create barrier for the new players.

On the other hand the bottlers are many and they do not add much value in the supply chain. In the past they were often dictated by the concentrate manufacturers. During 1990s and early 2000s lots of bottling manufacturers have started consolidation. This consolidation has now given more power to the bottlers. To avoid allowing more bargaining power in the hands of the bottlers, Pepsi and Coke is now purchasing some of the bottling companies to complete the full vertical integration. This will give them more leverage in the future.

The five forces of competition in the bottling industry includes rivalry, brand equity, new entrants, buyers and substitute products. Due to the duopoly in the market, Pepsi and Coke are rivals to each other who have been competing with each for decades. Brand equity is another competitive pressure with both the companies trying hard to draw in new customers and increase sales. New entrants are not a very strong threat to the companies as both Pepsi and Coke are quite entrenched in the market and have created a cartel with bottlers to make the entry of newcomers increasingly difficult. The companies sell their products to convenience stores, grocers and discount stores mainly in large volume but with the market demand having come to a saturation point, the bargaining power of the buyers is likely to increase. Substitute products like coffee, tea, energy drinks, bottled water put competitive pressure on the soft drink duos as there are many people who in order to avoid sugar are taking to coffee and tea.

3. How has the war between Coke and Pepsi affected the industry's profit? Price war was not a big thing during 1960s and 1970s. Around that timeframe the major marketing campaign employed by Pepsi was “ Pepsi

Challenge". This blindfolded testing of soft drink marketing helped Pepsi gain some market share but the price of none of the products from any of the companies was reduced significantly to trigger a price war. The main reason behind this was the franchise agreement between the two companies with the bottlers which made the price of concentrate subject to change based on sugar price only. However, towards the end of 1980s things started changing as Coke wanted to leverage its big brand value against its bottlers. It knew that it can bargain more with the bottlers and so it changed the contract pattern in 1986 with Pepsi soon following suit. With more power in hand to bargain with the bottlers Coke started a price war in 1990s. This resulted in some fierce price cut by both the companies especially to capture the large volume in the supermarket channel. In this process the profitability of the companies came down to single digit during 1990s. However, soon all the parties involved understood that this price war was not profitable for the business and the price war ended towards the end of 1990s. This period saw a lot of bottling plants shut down due to not being able to supply at low cost margin as demanded by Coke and Pepsi.

4. Can Coke and Pepsi sustain their profits in the wake of flattening demand and the growing popularity of non-carbonated drinks?

Though the demand for both these soft drinks has reached a saturation point in the US and non-carbonated drinks are growing popular, there are still many reasons for Pepsi and Coke to do well in the market and earn profits. First of all, they are in the business for several decades with no threat from new business competitors. Years of advertising and marketing have earned them a good brand reputation in the market and a loyal customer base

which would sustain the demand for their drinks for a long time. Secondly, keeping in with the market demand, they may diversify their portfolios and make new non-carbonated products like fruit juice and energy drinks which would leverage their brand. Globalization has boosted up their market in international level with India, China, Brazil, Russia and other developing nations being the primary focus of their business extension. All these developing countries are in booming economic stage and hence the per capita consumption of these drinks is likely to increase significantly. So there is a huge potential for growth for these two companies.