Coca-cola wars

Michael Porter’s “ 5-Forces Analysis” is a comprehensive way of determining organizations profitability as compared to its competitors in the same industry by looking at 5 forces of stress.

Coca-Cola deals with a lot of pressure in the concentrate business, most specifically with Pepsi. I will analyze the 5 forces model to determine Coca-Colas overall profitability. The 5 forces model begins by looking at rivalry between established competitors. Coca-Cola has a direct rivalry with Pepsi in the fact that they make and distribute an almost identical product used for the same purposes.

Because the concentrate industry, or the CSD (carbonated soft drink) industry, is dominated by Coke and Pepsi, their prices tend to be alike and the competition tends to focus more strongly on advertising, promotion and product development. Due to the similarity between both Coca-Cola and Pepsi products, the minimal product differentiation creates willingness from consumers for substitution and causes the company to force price cuts to increase sales. This was very obvious by Coca-Cola and Pepsi’s pricing wars and very heavy advertising and promotion expenses. The next force I took a look at was the threat of new entrants into the business. It is very hard for a new entrant to come into the concentrate industry and expect to compete with Coke and Pepsi. This is due in part to the barriers to enter the industry.

The costs alone to set up a new concentrate company are extremely expensive with R&D, fixed costs with production and manufacturing as well as other general start up costs. Another problem that new entrants face is the issue with economies of scale. A new company would be forced to enter at a very small scale (compared to Coke and Pepsi) and accept high unit costs, or enter at a large scale and take on the costs of underutilized capacity. This is especially difficult when facing competitors such as Coke and Pepsi whose ability to set prices very low would create insufficient profits for a new entrant trying to compete. New entrants would also face a very high advertising budget in order to achieve adequate brand awareness and general goodwill towards their brand.

Coke and Pepsi drinkers tend to be very loyal with their preferred choice, so it would take a lot of incentive from a new entrant to persuade consumers to try their new product. Finally, accessing distribution channels would also prove very difficult. The Soft Drink Interbrand Competition Act preserves the right of concentrate makers to grant exclusive territories. This prevents two or more bottlers to be in the same area with the same beverage. In addition, franchise agreements put constraints on what type of concentrate beverages could be produced at a bottling company.

For example, one bottler could not produce two separate brands of cola, but could sell a cola and a lemon lime type drink. The bargaining power of buyers also plays a large role in the profitability of Coca-Cola in the concentrate industry. The bottling industry is very price sensitive to the costs that the concentrate industry imposes on them. For example, when Coca-Cola and Pepsi were redesigning structures and strategies, they raised the concentrate prices by 7. 6%. This is a large pressure for the bottlers to absorb as they already were incurring large debts from manufacturing costs and equipment and process changes.

In addition to the buyers, the bargaining power of suppliers is another important force to recognize. The most important determinant of buyer power is the size and concentration of customers. Ultimate end buyers of CSD's are very brand loyal and tend to have low price sensitivity. Consumers don't have to be overly price sensitive with Coke and Pepsi as they have become so accustomed to pricing promotions.

Finally, the threat of substitutes is another force of Porter's model. The threat of a substitute is the likelihood that someone will switch to a competitive product such as beer, milk, coffee, bottled water, juice, tea, powdered drinks, wine, sports drinks, distilled spirits, and tap water. The threat of substitutes has increased for companies such as Coca-Cola and Pepsi due to the increased concern of health. The concentrate companies have reacted by coming out with Diet versions which have been hugely successful. The concentrate business has done very well with staying abreast of emerging trends by creating their own substitutes using their powerful name (such as water, tea, sports drinks, etc.).

To determine what these 5 forces mean in terms of the concentrate industries future profitability, I took a look at the industry's recent levels of profitability as well as the competition between Coca-Cola and Pepsi and determined their overall profitability using their current structures. The U. S. Beverage Industry is compromised of concentrates including CSD's, beer, milk, bottled water, coffee, juices, tea, sports drinks, powdered drinks, wine and distilled spirits. The consumption trends of CSD's more than doubled from 1970 to 1990 and continued to steadily rise well into 2000. Although very small, beginning in 2000 there was a slight drop in consumption followed by another minuscule drop in 2002-2004.

Although the change is slight and is not cause for alarm at this point, it does fit in with the changing environment of the industry. More and more choices are being introduced into the marketplace as well as changes in consumer behavior (dieting, changing preferences, etc.). These changes give reason to the slight drops in consumption. I do think that the amount of product offerings will continue to increase and that will make it more difficult for Coca-Cola and Pepsi to continue fighting for attention.

Luckily, these products buyers tend to be very loyal. Coke and Pepsi’s financial data both in the US and Internationally both prove what market giants they are. Among the increasing new entrants and product offerings, Coke is sitting financially stable. The company has seen steady increases with one of the largest jumps occurring between 2003 and 2004. Their international market has been decreasing slightly since 2001, but this makes sense as they have saturated so many international outlets. They still have a dominant role and their profits are not dropping at a questionable rate considering the saturation and product availability and selection.

Pepsi has also seen increases in their US sales, however, not by much. Their position is stable and growing, which is positive. Their international market coverage is small, yet is increasing. I think that due to the nature of the industry, it is safe to say that the concentrate companies (including Coke and Pepsi as a part of the CSD’s) will enjoy future success.

Amongst all of the competition there is a strong demand for these products. Paired with advertising and continued promotions, I think Coke and Pepsi will continue to be market leaders for carbonated soft drinks and that the concentrate industry as a whole will continue in its financial success.