Profitability in the soft drink market

The soft drink industry has been a profitable one in spite of the “ cola wars” between the two largest players. Several factors contribute to this profitability, and these factors also help to show why the profitability of the concentrate production side of the industry has been so much greater than the bottling side. Over the years the concentrate producers have experimented with different levels of vertical integration, and although it has not necessarily been clear which have been more successful historically, some decision criteria can be developed to help determine if and when complete vertical integration is necessary.

PROFITABILITY IN THE SOFT DRINK MARKET

As analysis using Porter’s five forces shows why the soft drink industry has been so profitable. Suppliers and buyers have not had more power over the industry than it has had over them. Internal rivalry, while seeming intense, has not eroded the profitability of the industry because of its concentration and the fact that the two major players have primarily competed on the basis of advertising and promotion and not price. Entry is difficult both for reasons of scale and the strong brand identity of the current major players. Substitutes have not been close enough to take away significant market share, although the emergence of new substitutes may pose the largest threat to the industry’s profitability.

THE MARKET ANALYSIS- MARKET STRATEGY

Coke was the leading Indian soft-drink brand in 1977 when a government regulation to share the Coke’s secret formula forced Coca Cola to exit India. Coke re-entered India in 1993 after the policies were relaxed a bit. Coke

acquired local Indian brands like Thums Up, Limca, Maaza, Citra and Gold Spot and made a strong come back into the Indian Markets.

PepsiCo entered India in 1989 with a joint venture with Parle Agro and Voltas India Ltd. In 1995, Coke had 52 % of the Indian soft-drink market share and Pepsi had around 42% market share. Since then Pepsi has had a really strong growth in India and has comprehensively pushed aside Coke sales in India.

Pepsi has had a strong Marketing campaign targeting mainly Youngsters which has worked wonders for Pepsi. Pepsi has had alliances with most of the popular actors, it has been the Official Sponsor of Indian cricket team for a long time now. Pepsi's ' Change The Game' ad campaign in the 2011 Cricket World Cup was a mega success and boosted the Sales a lot.

Coke also had some successful ad campaigns in the likes of ' Thanda matlab Coca Cola' and Coke – ' Open Happiness', the latest Coke ad is ' Burr Burr' ad series. A number of Pepsi and Coke challenges wherein participants with a blindfold are asked to taste Coke and Pepsi in plain cups and rate the better of the two, have been organized by these companies time and again. Coke had also introduced a Loyalty Points Awards program.

Pepsi's Distribution:

1) Exclusive contracts with franchise bottlers and independent distributors and retailers like Walmart.

2) Agreements with its competitors like Unilever with Lipton, Starbucks for Frappuccino.

Coke's distribution:

1) Independent bottlers with exclusive contracts.

2) Coca- cola enterprises.

Market – an institution that brings buyers and sellers together for specific goods and services.

Examples:

-New York Stock Exchange – market for buyers and sellers of stock for well-known corporations.

-Foreign currency market.

Assumption:

(1)The markets are perfectly competitive, i. e. large number of independent buyers and sellers.

(2)Equilibrium – a state of rest; model does not change.

The Market for Soft drinks

http://www. oocities. org/szulczyk/lessons/graphs/demand_supply_curve. gif

THE DEMAND AND SUPPLY ANALYSIS

DEMAND ANALYSIS

Demand analysis is about the curves that refer to the quantity of the good that a customer is willing to buy and able to purchase over a period of time, at a certain price is known as the quantity demanded of that good.

LAW OF DEMAND:

Law of Demand – as the market price increases, the quantity demanded for a good decreases, ceteris paribus.

1) The demand curve has a negative slope.

2) Price and quantity move in opposite directions.

Reason-

1) When products are expensive, people buy less.

2) The principle behind business discounts.

Law of Diminishing Marginal Utility – consuming additional units of a good yield less and less additional utility i. e. satisfaction.

-Example: Hypothetical.

1st Pepsi, a person receives 100 utils (lots of satisfaction), so he values it at $1 per bottle.

2nd bottle, a person receives 20 utils (some gain in utility), so he values it at $0. 75 per bottle.

3rd bottle, a person receives 5 utils (very little gain in utility), so he values it at $0. 25 per bottle.

-Total utility = 125 utils; total spent = $2

3) Composed of two effects.

-Income effect – as a product’s price decreases, a constant income buys more.

-Real income increases.

-Example: Monthly income $1, 000 and price of cold drink decreased.

-Income effect – you can buy more cold drinks with fixed income.

-Real income increased.

-Substitution effect – as price of a product decreases, people start buying it and “ substitute away” from more expensive, similar goods.

-Price change affects consumer’s behavior.

-Example: As the price decreases for Coca-Cola relative to Pepsi, people substitute Coke for Pepsi.

“ Change in Demand” – the demand curve shifts. Shift curves only “ left” or “ right.” Do not think of shifting curves “ up” or “ down.”

Demand Decreases

Demand Increases

http://www. oocities. org/szulczyk/lessons/graphs/demand_shifts_1. gif

http://www. oocities. org/szulczyk/lessons/graphs/demand_shifts. gif

Change in Quantity Demanded – movement along the same demand curve, because the price changed.

FACTORS AFFECTING DEMAND

(1)INCOME OF THE CONSUMER

There is a direct relationship between income of consumer and demand. Now coca cola being a normal good, if there's an increase in income, the demand will increase and vice versa.

(2)TASTE AND PREFERENCES

Taste and preferences of the consumers also influence the demand to greater extent. In case of coca cola, if there are hard core consumers who prefer the taste of coca cola, even if the price of coca cola increases, the demand will remain the same. But if the consumers have no taste or preference of coca cola, then if the price increases the demand decreases.

(3)GOVERNMENT POLICIES

As the study shows, there was a steep reduction in the demand of coca cola when the pesticides were found in few samples of coca cola. As a result consumer was shifting from coca cola to other natural drinks so therefore the demand for coca cola decreased. Time is an important factor that affects the demand of coca cola e. g. the demand for coca cola goes up during festive seasons and during summers

(4)AGE GROUP OF THE POPULATION

This product is meant for the children, adults and also for the old people so the age groups are not much affected the demand of the product so demand remain same and by the increase in the population, the demand of the product also increases.

SHIFT IN DEMAND CURVES

SHIFT IN DEMAND CURVE refers to the change in demand due to change in factors other than price.

Shift can be of 2 types-

1) Upward shift

2) Downward shift

UPWARD SHIFT-

When the demand for product increases, price being constant, due to change in other factors e. g.

Increase in income.

If there’s an increase in the income of consumers in the future, then there’s a possibility that the consumer will shift from local drinks in the market to coca cola.

SUPPLY:

LAW OF SUPPLY:

It states that if the price of a product increases, quantity supply will increase as the supplier will be willing to supply more to earn more profit. The law shows that there is a positive relationship between price and quantity supply.

Supply schedule- shows the quantity and price of a good that producers and sellers are willing to produce or sell, ceteris paribus. As the good's price increases, then quality supplied increases, ceteris paribus.

-Supply curves have a positive slope;

-As the price increases, the producers have an incentive to supply more goods.

Supply increases

Supply decreases

http://www. oocities. org/szulczyk/lessons/graphs/supply_shift_2. gif

http://www. oocities. org/szulczyk/lessons/graphs/supply_shift_1. gif

Change in Quantity Supplied – movement along the same supply curve in response to a price change.

DETERMINANTS OF SUPPLY:

(1)PRICE:

As stated in the law of supply, the price is positively related with quantity supplied for coca cola, in short run if there is an increase in the price of coca cola, the producers will be willing to produce more of the product.

(2)STATE OF TECHNOLOGY:

Due to change in the state of technology in the production process, the cost of production will reduce; as a result supplier will be able to supply more at same price

(3)NUMBER OF CONSUMER:

In the case of coca cola or pepsi there are large number of consumer, as a result the supplier are willing to supply more to cater the needs for the large number of customer.

(4)PRICE OF INPUTS:

Includes labour cost, machinery etc. if there is no scarcity in the supply of these factors so the cost for these factors will reduce as a result the producer is willing to supply more products at same price.

SHIFT IN SUPPLY CURVE:

Shift in supply curve means change in quantity supplied due to others factors while price remains the same.

1. Upward shift.

2. Downward shift.

UPWARD SHIFT:

Upward shift takes place when the supplier is able to supply at less at a same price. E. g. decrease in the supply of sugar due to increase in price and excessive exports of sugar results in decrease in production of coca cola.

DOWNWARD SHIFT:

Downward shift takes place when the suppliers are willing to supply at same price. e. g. Due to improvement in technology the cost of production decreases and the suppliers are willing to supply more at the same price.

Elasticity of demand

The elasticity of demand for a commodity is the rate at which quantity changes as the price changes. Price elasticity is found to be relatively elastic. This means if there is small change in price lead to the big change in quantity demanded. In this case the elasticity for demand is said to more than one(Ed > 1). From the figure we can see when the price of cold drink was p, the quantity demand was Q, when the price increases to P’ then the quantity demanded to Q’. Therefore we can say that cold-drinks are elastic in nature and its elasticity for demand is more than 1.(Ed> 1)

Elastic Supply Curve

Price

http://www. oocities. org/szulczyk/lessons/graphs/supply_elastic_1. gif

DETERMINANTS OF DEMAND ELASTICITY

(1)Availability of substitute:

In the case of coca cola substitutes are easily available in the market. The market is already flooded with many aerated drinks. Example: pepsi, LMN, mirianda, thumbs up, etc. So even if there is a increase in the price of coca cola, the consumers will shift their consumption from coca cola to aerated drinks because of easy availability of related substitutes.

(2)TIME:

The demand for coca cola is always related to a time factor. This implies that elasticity of demand varies with the length of time period. In case of long run elasticity of demand is elastic (because the period is long enough for the people to shift their taste and preference) and in case of the short run the demand remain inelastic.

(3)INCOME LEVEL:

The demand for coca cola is elastic for middle income group. The middle income group is sensitive to the change in price. Therefore if there is an increase in price of coca cola, the demand in the middle income group will decrease.

(4)PROPORTION OF INCOME SPENDS ON THE GOODS:

Coca cola is that product which is meant for the youngsters. In the long run the demand is relatively inelastic because even in the long run if there is a increase in price of coca cola even the hard core coca cola drinker will shift their preference because of the constrain in their pocket money whereas in short run the demand is inelastic.

INCOME ELASTICITY

If the income rises by 20% then the demand will rise by 10% the curve is positively sloped means that elasticity of Income is > 0 and <1. (When the average income was Rs. 10, 000 and demand was 100)

Inelastic Supply Curve

Price

http://www. oocities. org/szulczyk/lessons/graphs/supply_elastic_2. gif

CROSS ELASTICITY OF DEMAND

It is ratio of proportionate change in quantity demanded of Y to a given proportionate change in the price of the relative commodity X.

TYPES OF CROSS ELASTICITTY OF DEMAND:

POSITIVE-

When goods are substitute of each other then the cross elasticity of demand is positive. E. g. if the price of coca cola increases, this will lead to increase in the demand for other aerated drinks. In the figure given below, the horizontal axis represents demand for other aerated drinks whereas on vertical axis we measure price of coca cola. If the price of coca cola increases from Rs 5 to Rs 6 then the demand for coca cola will increase from 40 to 50 units.

INCOME ELASTICITY OF DEMAND:

It shows the way in which consumers purchase any good as a result of change in his income. As there is a positive relationship between incomes of the consumer and quantity demanded for coca cola, so we can say that coca cola is a normal good.

DETERMINANTS OF INCOME ELASTICITY DEMAND

-Level of income

If the income of the consumer is more than the quantity demanded for coca cola will be more and vice versa.

-Time period

Time period take the concept of marginal propensity to consume. If the consumers have high income they have more propensities to consume, hence the demand for coca cola increases and vice versa.

-Necessities versus Luxuries

It is harder to find substitutes for necessities so quantity demanded will change less.

-Availability of Close Substitutes

If there are close substitutes, buyers will move away from more expensive items and demand will be elastic.

-Market

The more broadly we define an item, the more possible substitutes and the more elastic the demand.

-Relative Size of Purchase

Purchases which are a very small portion of total expenditure tend to be more inelastic, because consumers are not worried about the extra expenditure.

Competitive forces for the soft drink industry

The soft drink industry is very competitive for all corporations involved, with the greatest competition being that from rival sellers within the industry. All soft drink companies have to think about the pressures; that from rival sellers within the industry, new entrants to the industry, substitute products, suppliers, and buyers. The competitive pressure from rival sellers is the greatest competition that Coca-Cola faces in the soft drink industry. Coca-Cola, Pepsi Co., and Cadbury Schweppes are the largest competitors in this industry, and they are all globally established which creates a great amount of competition. Though Coca-Cola owns four of the top five soft drink brands (Coca-Cola, Diet Coke, Fanta, and Sprite), it had lower sales in 2005 than did PepsiCo (Murray, 2006c). However, Coca-Cola has higher sales in the global market than PepsiCo. In 2004, PepsiCo dominated North America with sales of $22 billion, whereas Coca-Cola only had about $6. 6 billion, with more of their sales coming from overseas, as shown in Table 4 and Table 5. PepsiCo is the main competitor for Coca-Cola and these two brands have been in a power struggle for years (Murray, 2006c).

Diet Pepsi ranked 17th and Diet Coke ranked 36th as having the most loyal customers to their brands. The new competition between rival sellers is to create new varieties of soft drinks, such as vanilla and cherry, in order to keep increasing sales and enticing new customers.

New entrants are not a strong competitive pressure for the soft drink industry. Coca-Cola and Pepsi Co dominate the industry with their strong brand name and great distribution channels.

In addition, the soft-drink industry is fully saturated and growth is small. This makes it very difficult for new, unknown entrants to start competing against the existing firms. Another barrier to entry is the high fixed costs for warehouses, trucks, and labor, and economies of scale. New entrants cannot compete in price without economies of scale. These high capital requirements and market saturation make it extremely difficult for companies to enter the soft drink industry; therefore new entrants are not a strong competitive force (Murray, 2006c).

Substitute products are those competitors that are not in the soft drink industry. Such substitutes for Coca-Cola products are bottled water, sports drinks, coffee, and tea. Bottled water and sports drinks are increasingly popular with the trend to be a more health conscious consumer. There are progressively more varieties in the water and sports drinks that appeal to different consumers' tastes, but also appear healthier than soft drinks. It is also very cheap for consumers to switch to these substitutes making the threat of substitute products very strong.

Suppliers for the soft drink industry do not hold much competitive pressure. Suppliers to Coca-Cola are bottling equipment manufacturers and secondary packaging suppliers. Although Coca-Cola does not do any bottling, the company owns about 36% of Coca-Cola Enterprises which is the largest Coke bottler in the world (Murray, 2006a). Since Coca-Cola owns the majority of the bottler, that particular supplier does not hold much bargaining power. In terms of equipment manufacturers, the suppliers are generally providing the same products. The number of equipment suppliers is not in short supply, so

it is fairly easy for a company to switch suppliers. This takes away much of suppliers' bargaining power.

The buyers of the Coca-Cola and other soft drinks are mainly large grocers, discount stores, and restaurants. The soft drink companies distribute the beverages to these stores, for resale to the consumer. The bargaining power of the buyers is very evident and strong. Large grocers and discount stores buy large volumes of the soft drinks, allowing them to buy at lower prices. Restaurants have less bargaining power because they do not order a large volume. However, with the number of people are drinking less soft drinks, the bargaining power of buyers could start increasing due to decreasing buyer demand (Murray, 2006a).

CONCLUSION:

Since our product cold drink is elastic in nature therefore if there is a slight increase in the price of the product, there is a tremendous change in demand of the product because of the number of the substitutes available in the market.