

# Cola wars continue: coke vs pepsi in 2006

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



Q) Why the soft drink industry is so profitable?

A). The soft drink industry is profitable because the industry has concentrated revenues between 2 major players and it is virtually impossible for a new player to compete with the key players. The industry giant's wielded power over the retail outlets. Convenience stores, vending machines, fountains are widely distributed and hence they don't have the power to bargain over pricing issues and they also contribute to about 80 % of the sales. This ensures that the companies quote a maximum price and still have the final say in the matter.

Q) Compare the economics of the concentrate business to the bottling business: why is the profitability so different?

A). A concentrate producer has to blend the raw materials and ship them to bottlers in plastic canisters. A typical concentrate manufacturing plant has an initial capital investment of 25-50 million\$ and is capable of meeting the needs of an entire nation. Therefore the concentrate producer's main line of work shifts to advertising, research, and bottler support which ensures them a gross profit of 80%. The concentrate producer also enjoys added value in the form of access to branded names and unique formulas. A bottler manufacturer, on the other hand, has a capital-intensive business on hand, which has high costs to deal with with-concentrate producers and packaging activities being the major costs (up to 90%). The bottler's profitability is therefore considerably reduced with a gross profit of about 40%. Added to this the bottler also invests in distribution networks as a result of which the operating margins drop drastically to 7-9%. Therefore there is a wide

disparity in the profitability of a concentrate manufacturer and a bottler manufacturer.

Q) How has the competition between Coke and Pepsi affected the industry's profits?

A). The cola giants Coca-Cola and PepsiCo have, through their ' Cola Wars', brought about a revolutionary and welcome change in the industry. Both companies in vying with each other for the top spot have managed to create high-quality products spread over a wide range. Kicking off as soft drink manufacturers the companies diversified to other packaged foods and drinks thus increasing their consumer base as well as the industries. The introduction of the diet coke, for example, was lauded as the most successful consumer product launch in the 1980s. The aggressive entry of PepsiCo into the food business in the latter part of the 1990s also contributed handsomely to the company and as a result of the industry's profit.

Q) Will Coke and Pepsi sustain their profits through the late 1990s? What would you recommend to Coke to ensure its success? To Pepsi?

A). As time has shown the profits of both Pepsi and Coca Cola from the CSD industry hit a plateau in the 1990s. The US soft drink market, which is the largest market for both companies, began to see a slowdown at the time. As a result, the cola giants sought markets elsewhere; the Latin American nations and the largely untapped markets in Asia and Europe provided the breakthrough. Both companies now entered the virgin markets to establish themselves-Coca Cola through its Classic Coke and vending machines and PepsiCo through its flagship drink and its foray into packaged foods. In the

last decade, Coca-Cola has faced several execution (or non-execution) problems and lawsuits damaging the goodwill of the company; it must, therefore, concentrate on rebuilding its brand image and more importantly take chances on Mergers & Acquisitions. PepsiCo has been more successful and so needs to just keep up the energy and aggression of the last few years.

#### Growth rates

Growth	PEP (TM)	KO (TM)	PEP (5-Year Avg.)	KO (5-Year Avg.)
Sales	7.9%	4.3%	8.4%	7.9%
Net Income	38.4%	4.3%	18.6%	(5.8%)
Operating Cash Flow	4%	(7.3%)	9.8%	4.6%
The dividend (Yield)	1.9%	2.6%		

Source: Capital IQ, a division of Standard & Poor's

#### Advantage: Pepsi

No doubt about it, Pepsi is growing faster than Coke. Pepsi's sales growth was nearly double that of Coke for 2006. The gain is less on a five-year basis, but a 1.4% annual edge has allowed Pepsi's total sales to exceed Coke's by nearly 50% (\$35 billion vs. \$24 billion for 2006). On the bottom line, Pepsi's operating net income wasn't as strong as the 38% posted because a tax gain boosted reported results. But ignoring the gain, the 13% improvement still

bested Coke's 4% net income growth. Coke boosted its own figure by a couple of percents due to share repurchases, but Pepsi has been able to post much stronger income and cash flow growth over the past five years.

### Margins

Margin	PEP (TM)	KO (TM)	PEP (5-Year Avg.)	KO (5-Year Avg.)
Gross	54.3%	66.1%	54.9%	64.4%
Op.	15.8%	27.4%	17.9%	26.3%
Net	17.2%	21.1%	13.7%	21.1%

Sources: Capital IQ, Reuters

### Advantage: Coke

The edge picture best outlines the contrasts amongst Coke and Pepsi. As far as topography, Coke's quality is Pepsi's Achilles' foot rear area: universal. The lion's share of Coke's business is done outside of North America, and it posts higher edges there. Interestingly, Pepsi is least profitable universally, and it depends on its North American sustenance and refreshment income to drive its edges. It's likewise worth calling attention to that Pepsi, with its Frito-Lay and Quaker Oats divisions, is as much a sustenance organization as a refreshment purveyor, and these units are more productive than its drink operations in North America. At the end of the day, from an unadulterated pop-and-other-drinks point of view, Coke is far more productive. Pepsi's

nourishment hole shuts the edge setback impressively, however, Coke has possessed the capacity to post reliably higher edges by and large

Cash conversion cycle

Company (TM)	Days in Inventory (DII)	+	Days in Receivables (DIR)	-	Days Payables Outstanding (DPO)	= Average Conversion (CCC)
PEP	41. 8		33		94. 4	(19. 6)
KO	68. 6		36. 9		160. 6	(55. 1)

Source: Capital IQ

Advantage: Coke

Coke and Pepsi keep on posting impressive cash change cycles, as the negative CCC exhibits, they get money from clients rapidly, turn over their stock quickly, and require a significant stretch of time to pay off providers - which encourages them to cling to the money longer and, possibly, contribute it. Pepsi was predominant as far as DII and DPO for 2006, however, Coke's dominance of taking more time to pay its providers prompted a prevalent CCC for 2006.